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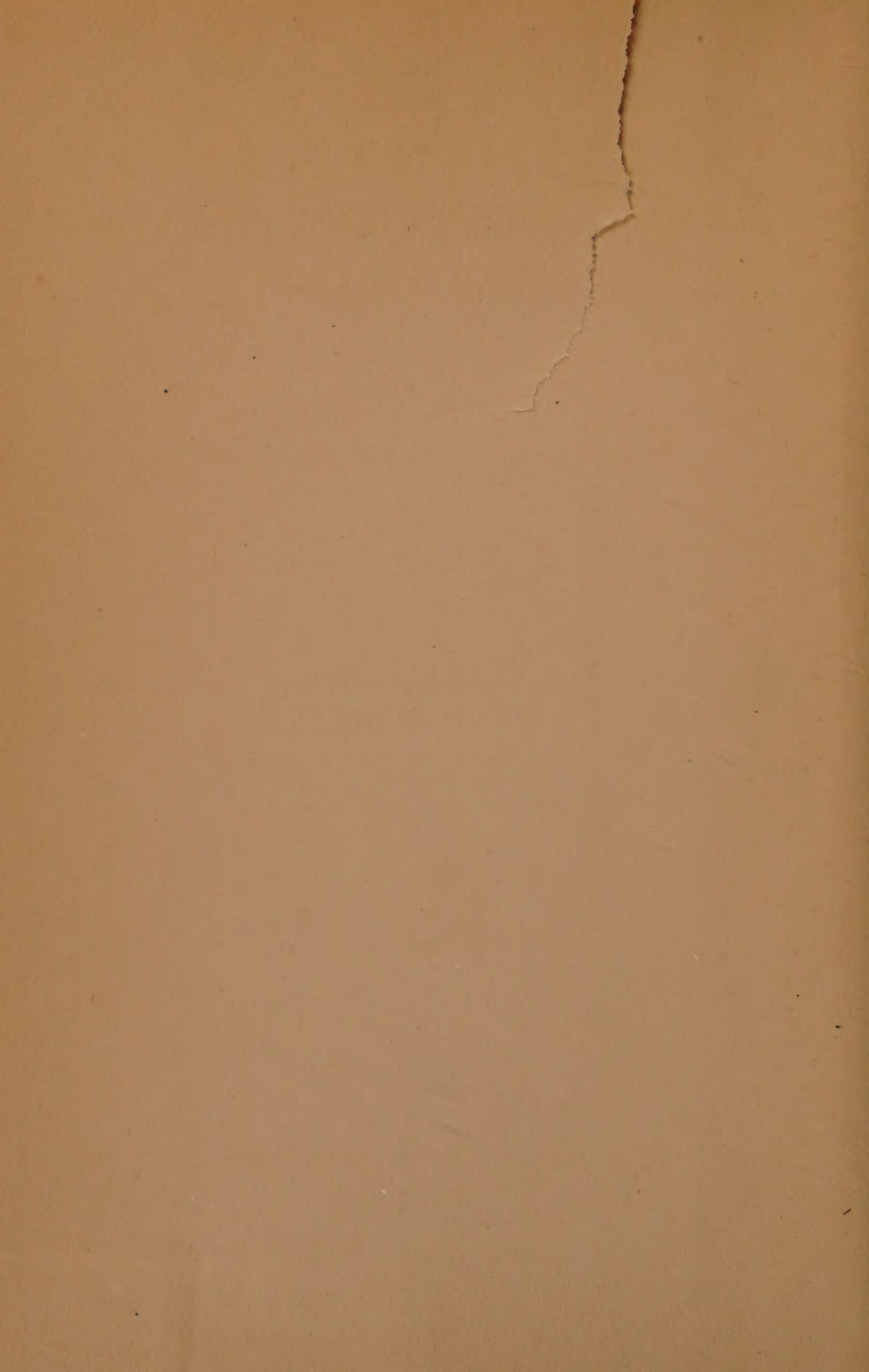


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With the author's  
sincere regards to  
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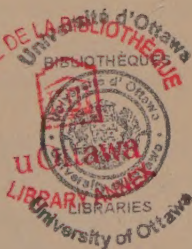
# INVESTMENT TRUST ORGANIZATION AND MANAGEMENT

By

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WITH AN INTRODUCTION BY  
PAUL D. CRAVATH



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## PREFACE

Since the war, and especially during the last two years, there has arisen in the United States a keen interest in investment trusts. In the process of liquidating her pre-war indebtedness to European nations, and especially to Great Britain, America, since 1916, has visualized, as never before, the profound influence exerted upon the development of her industries and natural resources by those British investment trusts through which foreign capital was mobilized for productive employment in the new world. The terrific strain withstood by British financial markets during the war, and the later return of sterling to parity have inevitably directed public attention to these cooperative agencies of domestic, as well as foreign, investment which contributed so materially to London's financial leadership. In view of the recent vast expansion in the ranks of American investors, and the increasing complexity and variety of overseas and home investments offered at the present time, it is not strange that investment trusts of one kind or another are being so rapidly organized in the United States, and that many of the recently created financing companies having extensive international interests are in more than one way adopting investment trust organization or methods.

In settling down to his present task of describing in some detail the creation and management of investment trusts and kindred companies, the author has found that the very novelty of his subject to most American readers created certain problems of exposition. There are probably four types of people to whom a book on investment trusts should carry information of immediate usefulness: (1) The prospective organizer or administrator of an investment trust, who desires to profit from the experience of others and to grasp underlying principles through



the medium of practical illustrations; (2) the banker and investment adviser who, confronted with numerous queries concerning a hitherto unfamiliar type of investment in America, the investment trust security, are under the necessity of advising their clients regarding investment trusts in general and one or another company in particular; (3) the prospective buyer of investment trust securities, who wishes to learn of the investment qualities of the latter and their general standing in foreign markets; and (4) the student who seeks light on fundamentals in order that investment trusts may be given their proper place in his conception of the entire financial mechanism.

The arrangement of the book is for these reasons designed to facilitate enquiry from more than one point of view. In giving this work what might be called a "practical slant" the author has endeavored to keep fundamental principles clearly in mind and to expound the theory where the fact is not self-explanatory. The earlier chapters deal with such matters of immediate concern to organizers and administrators as the legal status of investment trusts, their capital structure, raising of their funds, management of their investments, their accounting problems, and their earnings and dividends. The concluding chapters attempt a more detailed description of investment trusts in Great Britain, the European Continent, and the United States. In this way further light is thrown upon the preceding discussion of operating methods. This division of the subject also frees the earlier exposition from a mass of unnecessary detail concerning types of companies to be found in different countries.

Investment bankers called upon to give advice to clients, as well as investors themselves, will find in Chapters XV and XVI at least a brief description of practically every investment trust functioning in the United States at the present time. In Chapter XIII is a set of concisely formulated principles which may aid in distinguishing clearly the differences between investment trusts, and holding and financing companies, which

are so often confused in the public mind. In this and the following chapter are to be found references to a large number of recently developed American organizations which, though not investment trusts, show some characteristics of the latter and may logically be studied at the same time. In Chapters XI and XII the characteristic points of contrast between British and Continental investment trusts are derived from a study of different companies, which affords ample illustrative data for further comparisons with the many American undertakings referred to in subsequent chapters.

Those readers who are less interested in detailed exposition than in a broad statement of the purpose and characteristics of investment trusts, and the future importance of this type of financial institution in the United States will probably find particularly suggestive the subject matter of Chapters I, III, V, VI, and XVII. A reading of these chapters, with use of the index for further references of especial interest, should give the student an accurate picture without burdening him by more technical matter than he needs for his general studies. The appendix matter, covering a wide range of data having practical present interest, will, the writer hopes, increase the usefulness of the book to the student and the administrator alike.

The friends and associates to whom the writer is indebted for material and suggestions are too numerous to mention, but to any of them who may peruse these pages he takes this occasion once more to express his gratitude. He wishes, however, especially to mention Dr. Julius Klein and Mr. Grosvenor M. Jones who, as Director of the United States Bureau of Foreign and Domestic Commerce, and Chief of its Finance and Investment Division, respectively, encouraged the undertaking of his earlier studies in London; Mr. Robert Frazer, of the National City Company, London, and Lt. Colonel William Parker of that city, who have given helpful advice; Mr. Samuel Cross, formerly American Commercial Attaché in Brussels,



and now Chief of the European Division in the Bureau of Foreign and Domestic Commerce, and Mr. E. Van Dyke Wight, American Assistant Trade Commissioner in Belgium, who opened many doors to him in that country; Mr. Nathaniel Bergman, of the taxation division of Lybrand, Ross Bros. and Montgomery, who has furnished helpful data concerning taxation problems; and Mr. Paul D. Cravath, whose friendly interest in the completion of the book has greatly encouraged the author. The list would be long, indeed, were it possible to acknowledge specifically the painstaking care and unfailing good humour with which investment trust executives, at home and abroad, have furnished detailed data in answer to written as well as verbal requests.

Despite the great importance of investment trusts during the last half century there is little literature to which the student of this subject may be referred for supplementary reading. Writings in this field, while fairly voluminous, have been almost exclusively of purely contemporary or passing interest because they dealt with the current position of particular companies rather than the scope, progress and underlying principles of the movement as a whole. It is the author's hope that in this volume he may have succeeded in drawing together and helpfully organizing the data relating to investment trusts accumulated by his investigations extending over several years, and that within these covers the reader will find a systematic exposition of most matters touched upon by other serious, though fragmentary, treatises to which reference is made in relevant sections of the text. It is also hoped that sooner or later any deficiencies in the present volume may be more than made good by such an abundant and up-to-date literature as usually accompanies any virile movement of this character in the United States.

LELAND REX ROBINSON

New York,

March 20, 1926.



# CONTENTS

CHAPTER	PAGE
<p>I PURPOSE AND CHARACTERISTICS OF THE INVESTMENT TRUST . . . . .</p> <p>Importance of investment trusts; definition; legal and economic concepts contrasted; distinguished from trust companies, from financing companies; status in Great Britain, in the United States; memoranda of association.</p>	<p>3</p>
<p>II LEGAL STATUS OF AMERICAN INVESTMENT TRUSTS . . .</p> <p>Corporations and common law trusts; the latter defined; Massachusetts trusts; common law trusts compared with corporations; means of incorporating investment trusts; Edge Act; comparative advantages of common law trust and corporate forms.</p>	<p>18</p>
<p>III THE STRUCTURE OF INVESTMENT TRUST CAPITAL . . . .</p> <p>Three types of securities issued; common stock, and shares of beneficial interest; "splitting" investment trust shares; preferred stock and its characteristics; advantages of exercising borrowing power; limitations upon such exercise; bonds and debentures—maturity, redemption, rates and yields; short-term loans.</p>	<p>36</p>
<p>IV THE RAISING OF INVESTMENT TRUST CAPITAL . . . . .</p> <p>Reasons for late development in the United States; psychological factors; appeal of investment trust securities; marketing problems; "tap sales" versus occasional flotations; cost of raising capital; prospectuses quoted.</p>	<p>59</p>
<p>V MANAGEMENT OF THE PORTFOLIO . . . . .</p> <p>Three criteria of investment; standards of diversification; geographical distribution; distribution by issuer; distribution by type of security; policies of investment publication; distribution of investments illustrated; underwriting, and its relation to purchasing; group agencies in administration.</p>	<p>80</p>
<p>VI MANAGEMENT OF THE PORTFOLIO (Continued) . . . . .</p> <p>Static and dynamic points of view; turnover policies, and "business profits" in investment—the age factor, the distance factor, the credit cycle factor, the risk factor; "nursing investments"; size and efficiency; résumé of investment trust executive's duties.</p>	<p>102</p>
<p>VII ACCOUNTING PROBLEMS . . . . .</p> <p>Three principal problems; balance sheet figures and market quotations; profit from depressed markets; "contingent funds" and concealed reserves; contrasted practices of financing companies; valuation methods.</p>	<p>124</p>

VIII	ACCOUNTING PROBLEMS (Continued) . . . . .	143
	Payment of dividends while capital is impaired; the Verner case; crediting accrued interest; taxation complications; accuracy in accounting.	
IX	EARNINGS OF INVESTMENT TRUSTS . . . . .	158
	Sources of income; investment income; difficulties of international comparison; investment yields; management expenses; ratios of administrative expense; dividend rates; "interim" and "final" dividends; values and yields of investment trust securities.	
X	EARNINGS OF INVESTMENT TRUSTS (Continued) . . . . .	174
	Analysis of typical companies; statistical chronicle of the Edinburgh Investment Trust; of Second Edinburgh Investment Trust; contrasted dividend policies; war experience of investment trusts.	
XI	TENDENCIES IN BRITISH INVESTMENT TRUST DEVELOPMENT . . . . .	187
	Chronological survey; difference between Scottish and English companies; shifting of investment trust holdings; recapitulation.	
XII	CONTINENTAL INSTITUTIONS AKIN TO THE INVESTMENT TRUST . . . . .	207
	Financing company characteristics of Continental investment trusts; investment policies of the banks; the investment trust in Belgium; further illustrations drawn from French companies; "financing investment trusts" in Switzerland, in Germany.	
XIII	AMERICAN FINANCING COMPANIES . . . . .	230
	Cardinal principles long applied; agricultural credit institutions; public utility holding companies; "financing investment trusts" illustrated; American International Corporation; projected Foreign Trade Financing Corporation; other American financing companies of recent origin—United States and Foreign Securities, American and Continental, Swedish American, European Shares, German Credit and Investment; investment liaisons with foreign banking groups.	
XIV	STOCK CONVERSION COMPANIES . . . . .	264
	Stock conversion trusts defined; other applications of same idea; American stock conversion trusts illustrated; common features of "bankers' share" offerings; recent developments of latter; pros and cons of the bankers' shares; contrasted with the investment trust.	
XV	A PIONEER AMERICAN INVESTMENT TRUST . . . . .	282
	Originality among American investment trusts; International Securities Trust of America—scope of operations, fundamental investment standards, portfolio management, diversification provisions; capital profits in depressed and buoyant markets; nature of securities issued; relations with fiscal agent; market for issues.	

XVI	RECENTLY ORGANIZED AMERICAN INVESTMENT TRUSTS .	299
	Two main types; investment trusts acting as joint management agencies—Investment Managers Company, Alwyn Corporation, Alexander Fund; investment trusts of more formal type—New England Investment Trust, Massachusetts Investors Trust, other similar companies; trusts specializing in shares of financial institutions; Financial Investing Company; Morristown Securities Corporation; American Bond and Share; recapitulation; other means of classification.	
XVII	OUTLOOK FOR INVESTMENT TRUSTS IN THE UNITED STATES . . . . .	332
	Emergence of small investor; complexity of corporate finance; world creditor position; changing investment viewpoints; investment problems of endowed institutions; probable types of American investment trust offerings; interests of promoters; centralization of management; the prospect.	
APPENDIX		
A—	Section I: Principal British Investment Trust Companies Classified According to their Main Groupings. . . . .	351
	Section II: Approximate Total and Average Outstanding Capital, Debenture and Share, of the Principal British Investment Trusts . . . . .	354
	Section III: A Few British Trusts Concentrating Their Interests in Certain Areas or Industries . . . . .	354
	Section IV: British Trusts Organized for the Purpose of Effecting Financial Rearrangements . . . . .	355
	Section V: A Few Typical British Companies Doing in Part or Whole a Financing Business . . . . .	355
	Section VI: Certain American Investment Trusts, Including Several with Specialized Holdings, with Dates of Their Organization . . . . .	356
	Section VII: Certain American Financing Companies Having Foreign Interests, and Operating as "Financing Investment Trusts" in Whole or in Part . . . . .	357
B—	Chronological Table of Organization of Leading British Investment Trusts . . . . .	358
C—	A Complete Declaration of Trust of a Massachusetts Trust, Operating as an Investment Trust . . . . .	361



D—Section I: Balance Sheet, Income Account, Capital Outstanding, and Estimated Surplus of the International Securities Trust of America . . . . .	377
Section II: Revenue Account and Balance Sheet of the Industrial and General Trust, Ltd. . . . .	380
Section III: Balance Sheet and Profit and Loss Account of Société Générale d'Entreprises (Paris) . . . . .	384
E—Notes on Federal and State Taxes from the Standpoint of the Common Law and Corporate Forms of Investment Trust .	386
F—Regulations of the Federal Reserve Board Concerning the Application of the Edge Act . . . . .	392
G—The London Financial Times (1925) Analysis of Capital, Earnings, Dividends and Reserves of Leading English and Scottish Investment Trusts . . . . .	402
H—Composition of the Portfolio, December 31, 1923, Banque D'Outremer (Overseas Bank) of Brussels . . . . .	412
J—Prospectus of Nation-Wide Securities Company . . . . .	415
K—Condition and Income Statement, Investment Trust Certificates, Series A, Investment Managers Company, New York	422
L—Prospectus of Mid-European Corporation . . . . .	425

## INTRODUCTION

Dr. Robinson's book on the investment trust is most timely. It is the first comprehensive discussion of the problems of investment trust organization and management that has appeared in America, or indeed, in the English Language.

Dr. Robinson aptly defines the investment trust as "an agency by which the combined funds of many investors, both in large and small amounts, are utilized to purchase such a wide variety of securities that safety of principal is attained in diversification . . . while the portfolio is so managed that a good average yield is sought on share and borrowed capital, at the same time that close supervision of the portfolio permits a turnover policy aiming at the realization of capital gains and the avoidance of capital losses."

The important part played by British investment trusts in making London the financial capital of the world is now generally recognized. The investment trust was admirably adapted to meet the needs of that large class of British investors, especially those of the leisure class, who, in choosing their investments, preferred to follow trained leaders rather than to depend upon their own judgment. In time the judgment of the great leaders in the investment trust field, like Robert Fleming, came to be regarded as almost infallible.

There is no magic in the successful investment of capital. It calls for honesty, prudence and intelligence. Given those qualities in reasonable degree, an investment trust cannot fail, while the measure of its success will depend, partly on chance, but chiefly, on the wisdom and foresight of its managers.

Before the War the investment trust idea made little progress in America. There were several reasons for this. In the first place, the American people had not developed the

investing habit. New issues of securities were placed chiefly with insurance companies and other institutions, and with men of large wealth. As a rule investors of this class felt that they were in a position to form their own opinions regarding their investments. In the second place, the self-reliant American temperament did not lend itself to the development of a disposition among investors to follow financial leaders. The average investor preferred to form his own opinion regarding the enterprises in which he invested, which were usually domestic enterprises, comparatively few foreign investments having been offered in America.

The war has changed all this. The high surtaxes have practically forced investors of large means to confine their investments to tax exempt securities. Their place has been taken by an army of investors of small or moderate means scattered throughout the country, who have made money as a result of the war and who during the war developed the investment habit by the purchase of Government securities. The bulk of the securities now marketed in the United States is placed among the rank and file of investors through the selling organizations of dealers. To investors of this class the investment trust should make a strong appeal, especially as American investors come to realize that in the long run they are safer in following the advice of experienced and trustworthy leaders than in relying upon their own judgment. This is especially true of the numerous issues of foreign securities now being placed in this country regarding which the individual investor is rarely in a position to form a judgment of his own. American investors are also coming to realize the advantages of that wide diversification in investments which can be accomplished through investment trusts.

The United States has become not only the most important investment market in the world today, but perhaps the most important the world has ever known. The widespread recognition of the importance of the investment trust under these



new conditions is indicated by the recent organization of a number of enterprises based on the investment trust principle. Whether the investment trust will enjoy in this country a development parallel with its development in England during the heyday of her prosperity as the investment center of the world will depend upon many factors and especially upon the wisdom and skill with which the first American enterprises organized on the investment trust principle are managed and the extent to which the advantage they offer are understood by investors. Hence the importance of Dr. Robinson's book at this particular time.

Dr. Robinson brings to the task he has undertaken exceptional qualifications as the result of the experience gained during his association with the Department of Commerce; his two years residence abroad as Westinghouse Professor of American Business Administration, and more recently his intensive study of the management and operation of investment trusts, both in this country and Europe.

PAUL D. CRAVATH



**INVESTMENT TRUST  
ORGANIZATION AND  
MANAGEMENT**





## CHAPTER I

### PURPOSE AND CHARACTERISTICS OF THE INVESTMENT TRUST

**Investment Trusts and the Capitalist System.**—The development of modern corporate enterprise has so standardized the forms of investment as to permit the concentration of scattered savings for industrial and commercial ends on a scale undreamt of in former centuries. The evolution of the capitalist system, however, has so complicated the problems of investment that a great majority of people are bewildered by the variety of securities offered them, and unable to interpret intelligently the intricacies of the financial statement, the vagaries of the stock exchange, or the changing phases of the credit cycle. Thus at a time when business rests upon foundations of co-operative credit and demands the financial participation of rich and poor alike, the great majority either deprive themselves of a reasonable return by seeking safety only, or needlessly risk their capital in haphazard and fortuitous investment. These circumstances explain the creation of investment trusts.

**Investment Trusts and the Export of Capital.**—There is another factor which partly accounts for the great interest in investment trusts prevailing in America today, and for their surprising European, and especially British, development. This is the further complication which distance and unfamiliarity, aggravated by political barriers, lend to investment in a world where financial interdependence tends to increase, at the same time that a virile nationalism imposes its hurdles of varying currencies, regulations, business laws and languages.

Despite these difficulties encountered in geographically

broadening investments, the movement of goods in international trade is obviously closely linked with the flow of capital. The operation of the basic law of comparative costs, hindered at all times by political factors, is continually modified by the credit terms upon which commerce is conducted, and in any exporting nation the long- and short-time credit facilities available for foreign customers must develop *pari passu* with the mechanism of production. Unless its goods and services represent in large measure payment for earlier advances, a country possessing a "favorable" trade balance must maintain credit intermediaries which facilitate the lending of its capital abroad; while it is axiomatic that any creditor nation must show a variety of institutions which have simplified the placing of investments abroad.

**Importance of Investment Trusts to the United States.—**

It is, therefore, no mere coincidence that the United Kingdom, the world's greatest lender until the United States recently took foremost position among creditor nations, is also considered the homeland of the investment trust. In fact, the English and Scottish trusts have proved the most important factor in the export of capital from the British Isles, both to the Dominions and colonies, and to every foreign nation whose resources have been developed by British advances. The United States owes much of her national development, from the seventies until the outbreak of the Great War, to the quiet activity of investment trusts domiciled in London and Edinburgh. It is, therefore, logical that at a time when the United States has attained a creditor position, and the world is much in need of its capital, there should develop an American equivalent of the long-established British trust. Adapting to their own use such principles as foreign experience has proved sound, and modifying their structure to suit the peculiar needs of this country, there is no doubt that American investment trusts will open the doors of new opportunity to the average

investor, encourage sound enterprise within the country, and contribute to the creation of a firm foundation for our expanding foreign commerce.

**The Investment Trust Defined.**—What is an investment trust?<sup>1</sup> A broad definition might be worded as follows: The investment trust is an agency by which the combined funds of many investors, both in large and in small amounts, are utilized to purchase such a wide variety of securities that safety of principal is attained in diversification, while no control, or directive responsibilities, result from investment. Furthermore the investment portfolio is so managed that a good average yield is sought on share and borrowed capital, at the same time that close supervision of the portfolio permits a turnover policy aiming at the realization of capital gains, and the avoidance of capital losses.

According to the above definition, the typical investment trust will show the following characteristics:

1. It raises capital by issuing stock, generally both preferred and common; and it frequently exercises its borrowing powers by creating bond indebtedness, and occasionally in other ways.
2. The funds so obtained it invests and reinvests in a wide variety of securities, distributing risk over many industries, countries, and types of issues.
3. It appeals to the cautious investor by offering bonds and stock participation in reasonable denominations; and it aims to protect his interests, whatever the nature of his holdings, by skilful management of the investment portfolio.
4. In addition to offering the greater security which results from intelligent diversification, the typical investment trust holds out to its common stockholders the expectation of con-

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<sup>1</sup> In this definition, and throughout the book the writer has used the term "investment trust" in its ordinarily accepted British meaning. The reason for this is that, as will appear later, the Continental type of investment trust is really a financing company, and the American development is in its infancy. As there are so many ways of conserving or holding property under one or another kind of trust agreement, this may seem arbitrary usage; but historically speaking, the concept of the investment trust is perfectly clear, and no definition is possible without some degree of arbitrariness.

siderable enhancement in earning power of their shares. This primarily arises from (a) a higher average yield than can be safely obtained without a volume of capital permitting considerable spreading of risk; (b) the reinvestment of borrowed funds at higher return than the cost of these funds to the borrowing investment trust; and (c) the balance of capital gains (generally used to strengthen reserves) which a well-conducted trust should show as the outcome of its managerial alertness.

**The Legal Concept Contrasted with the Economic.**—From the foregoing it will be evident that the term “trust” has been used in its economic, rather than its juristic, significance. The distinguishing characteristics of investment trusts are those sketched in preceding paragraphs, rather than the legal forms which they may take. In the following chapter these legal forms are described, and there it will be seen that the great majority of investment trusts do business as corporations, although illustrations are not lacking of their organization as strict trusts without corporate entity. Both the common law trust and the corporate form of legal entity serve the purposes of the investment trust well enough in our country; and the balance of advantages on one side or the other results from weighing such factors as taxation, stock exchange listing, and the public familiarity with, and attitude toward, the proposed legal set-up.

**Investment Trusts Distinguished from Trust Companies.**—For the American reader especially a distinction must be made between the “trust company” found in the United States, and the investment trust (sometimes known as the “financial trust” or “trust company” in England and Scotland). The former has been aptly termed “the department store of finance.” Of the wide variety of services rendered by the typical state trust company in the American system—banking, fiduciary, agency, issuing, and investment—the investment trust concerns itself



exclusively with the last, save that in the United Kingdom it is common practice among such companies to enhance their income incidentally by accepting such trusteeships, registrarships, or secretaryships as the time of their staff readily permits, and to undertake certain types of underwriting as ancillary to their investment policy.<sup>2</sup> The investment trust might also be compared with what has become in the United States the equivalent of the powerful trust company—the large commercial bank incorporated under national or state law—with the savings bank, the insurance company, the holding company, and, in fact, with any business organization having considerable or diversified investments.<sup>3</sup> These, however, exist primarily for an entirely different range of services than that of co-operative investment and portfolio management, and their purchase of securities, except in the case of the holding company, is only a means of profitably employing and safely mobilizing their disposable funds.

**Investment Trusts and Financing Companies.**—Although the investment trust may be easily recognized, whatever its legal form, a greater difficulty attaches to drawing a hard and fast line between the latter and those organizations which may be more accurately designated as financing or promoting companies. Each employs capital derived from issue of its own shares and bonds, and reinvests this in the securities of other enterprises. The investment trust deals with investments as such—the interest and dividends accruing therefrom, and the profits resulting from turnover therein—and as a rule avoids those larger holdings involving responsibility in particular undertakings. The financing company, on the other hand, operates within a far more restricted field, assumes directive responsibilities toward subsidiary enterprises, and shows in its revenue statements the whole range of promoting profits—from issuing

<sup>2</sup> See Chapter V.

<sup>3</sup> For detailed discussion of American financial and banking companies resembling the investment trust in one or another way, see Chapter XIII.

and underwriting, from the enhanced earning power of subsidiary undertakings founded or fostered by the parent company, and from the capitalization of the rising dividends therefrom.<sup>4</sup> In Chapters XIII to XVI the reader will find a more detailed description of the differences between financing companies and investment trusts, with numerous illustrations drawn from current American experience.

**Status of Investment Trusts and Financing Companies in Great Britain—I. INVESTMENT TRUSTS.**—Easy as it is in principle to set apart the true investment trust from the financing, promoting, or holding company, such distinction is often difficult in practice because of loose classifications used in financial reference books, and the impossibility of always forming true estimates of activity from scanty available records.

In Great Britain, for instance, where investment trusts constitute an essential link in the financial chain, official lists do not always segregate them clearly. There appear in the published company lists of the London Stock Exchange Committee about one hundred and fifty "Financial Trusts," and under the same caption the Stock Exchange Ten Year Record<sup>5</sup> gives about one hundred companies. Under the title "Financial, Land, and Investment Companies" both of the above sources list a large number of what we have called "financing companies," among which will be found a sprinkling of investment trusts, and many companies carrying on a combination of investing and financing business. The actual investment trusts must be selected from these larger lists by examining the nature of each company's business. Through the courtesy of several investment trust officials, and by studying reports of each company it has been possible to segregate about eighty which are investment trusts in the stricter sense of the term, and which include a majority of British institutions of this type. These companies appear in

<sup>4</sup> For certain very interesting distinctions in law and accounting practice, which arise between British investment trusts and financing companies, see Chapters VII, VIII, and XI.

<sup>5</sup> A record of prices and dividends compiled with ten-year comparisons by Frederick Mathieson and Sons, London.

Section I of Appendix A, and as far as possible they are classified in the several groupings formed by interlocking directors or identical managements.

It will be seen from Section II of Appendix A that the outstanding share and debenture capital of these British investment trusts is well over £100,000,000, if allowance is made for normal growth since 1921, the last year for which the writer has made detailed compilations. The figure of £100,000,000 for 1921 represents capital raised in approximately equal proportions by the sale of preferred shares, common shares, and bonds, and it compares with an outstanding capital of £75,000,000 in 1912 for the sixty-two companies of which earlier totals are given. The average outstanding capital of British investment trusts in 1912 was £1,200,000, and in 1925 it was something over £1,300,000.

2. SPECIALIZING INVESTMENT TRUSTS.—The number of investment trusts in Section I of Appendix A would be greatly increased if all those British companies interested for the most part in investment, but concentrating their holdings in some particular area or industry, were included. The companies in Section III of Appendix A are investment trusts of this kind, although the list is not inclusive. Mention might also be made of trusts formed to absorb blocks of securities in certain companies, but omitted from Section I because they do not undertake a general business. In Section IV of Appendix A several companies of this kind are cited. They have been employed as agencies in refinancing arrangements which aim to realize on otherwise unmarketable securities, or to convert them into more convenient denominations, types, or maturities.

3. BORDER-LAND COMPANIES AND FINANCING CORPORATIONS.—No lists of the kind given in Appendix A can be considered complete because of the large number of British companies in the twilight zone, between investing and promoting business. Thus a bond issuing investment trust may purchase

securities for its portfolio and at the same time utilize a portion of its funds to buy a controlling interest in some foreign or colonial enterprise, or assist new undertakings to their feet. Such trust companies are not included in Section I of Appendix A, but a few of the representative ones are enumerated in Section V, which also gives a number of companies ordinarily appearing among investment trusts, but really doing a financing business.

If all of the active financing companies of Great Britain were added to Section V of Appendix A, there would be more than one hundred of such companies, with a total outstanding capital of over £150,000,000, divided in about the proportion of £110,000,000 in preferred and ordinary stock and £40,000,000 in bonds.<sup>6</sup> Capital provided by such companies has been used to develop real estate, acquire land mortgages, sink mines, build railways—in fact to finance every kind of project. No clear-cut line can be drawn between financing companies which are actively interested in particular enterprises, and oil, railway, mining, and other concerns registered under the British Acts and engaging directly in some overseas business. The difference is that financing corporations lend money to several enterprises, acting often as issuing agents or holding companies, whereas the latter are concerned with business, as contrasted with financial, profits.

**Investment Trusts in the United States.**—Of investment trusts, as defined in earlier paragraphs of this chapter, the United States has comparatively few examples, although considerable numbers are now developing. In Section VI of Appendix A, the reader will find fifteen or so American companies which may properly be so classified, while Chapters XV and XVI give a brief description of each of them. Almost

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<sup>6</sup> In arriving at these totals, the following companies, which are for the most part engaged in financing railroads, are excluded: Central Bahia Railway Trust; Mexican Central Railway Securities; Rhodesia Rails Trust; Stock Conversion and Investment Trust; Tonopah and Tidewater; and one or two others generally rated as either "Financial Trusts," or "Financial Land and Investment Companies." The separate figures are taken from Mathieson's Record, and do not always agree with published reports of the several companies.



without exception they have been organized within the last five years. Their capital is necessarily small with one or two exceptions, and their experience is so limited that it is impossible to predict what may be the average ratio of their borrowed, to their share capital. Especially in recent years there have been organized in this country financing companies spreading their interests among selected foreign enterprises, and materially contributing to the export of American capital. These enterprises, which are described in Chapter XIII, are listed in Section VII of Appendix A, although neither this nor the preceding section lays claim to completeness. Holding, promoting and financing companies interested primarily in the domestic field, and especially in public utilities of all kinds, have long been all-important in American business. These, however, need only this passing mention.

**Memoranda of Association of Investment Trusts Illustrated.**—It will perhaps not be out of place at this point to quote from the Memorandum of Association or Declaration of Trust of two investment trusts—one British and the other American. The Investment Trust Corporation, Ltd., which was registered under the British Companies Acts in 1888, affords a typical example :—

INVESTMENT TRUST CORPORATION, LTD.

3. The objects for which the Company is established are:

(a) To raise money by share capital, and invest the amount thereof in, or otherwise acquire and hold, any bonds, stocks, obligations, or securities of foreign or colonial or British governments, etc., or the bonds, debentures, debenture stocks, scrip, obligations, shares, stocks, whether preference or ordinary, and whether fully paid or not, or securities of railway and other companies, public works and undertakings incorporated or established by act of Parliament, Royal Charter, or under the joint-stock companies' acts in England or the Colonies, or by state authority or under the laws of any foreign country or state.

(b) To borrow or raise money by the issue or sale of any bonds,

mortgages, debentures or debenture stock of the Company, or in any other manner to receive money on deposit at interest or otherwise, and to invest the amount so obtained in securities or investments of the kinds enumerated in the last preceding sub-section.

(c) To acquire any such securities or investments as before mentioned by original subscription, tender, participation in syndicates or like negotiations, or otherwise, and whether or not fully paid up, and to make payments thereon as called up, or otherwise to acquire any such securities or investments in excess of the moneys for the time being proposed to be invested, and to sell or otherwise dispose of any excess thereof, to subscribe for the same, either conditionally or otherwise, and generally to sell, exchange, or otherwise dispose of any securities or investments of the Company, acquired or agreed so to be, to invest in or acquire by repurchase or otherwise, any securities or investments of the kinds before enumerated, and to vary the securities and investments of the Company from time to time.

(d) To make advances upon, hold in trust, issue, buy, sell, or otherwise acquire or dispose of, on commission, or otherwise, any of the securities or investments of the kinds before mentioned, or to act as agent for any of the above or the like purposes.

(e) To make, draw, accept, indorse, issue, discount, and otherwise deal with promissory notes, bills of exchange, letters of credit, circular notes, and other mercantile instruments.

(g) To do all acts necessary for carrying on, in any foreign country or colony, any act of the Company necessary or expedient to be there carried on.

(h) To do all or any of the matters aforesaid, either alone or in conjunction with any other company, corporation, or person, and that either by amalgamation or otherwise.

From the above it will be seen that the Investment Trust Corporation has assumed powers to enter into promoting and exchange operations, and that it might, if it chose, engage in all kinds of long- and short-time trade financing. It must be borne in mind that the British Companies Acts, under which all corporations function in the United Kingdom, are less restrictive than the special American national and state laws under which banking charters are granted. The powers reserved in the Memorandum of the Investment Trust Corpora-

tion stand in contrast with the ruling of the Federal Reserve Board that corporations organized under the Edge Act should in the main confine themselves to the acceptance and exchange, or the long-term financing, type of business. As a matter of practice, however, the Investment Trust Corporation is almost exclusively of the latter type and does not mix two totally different lines of activity. What the Federal Reserve Board requires by formal ruling, the British investment trusts have accepted as the result of long experience.

The Declaration of Trust of the Bond Investment Trust, a trust of the state of Massachusetts, which, except for the fact that its investments are limited to prior lien securities, is conducting a general investment trust business, is in part as follows:

#### BOND INVESTMENT TRUST

This Declaration of Trust . . . . witnesseth:

It is the object of this Declaration of Trust to provide a form of investment which encourages thrift and allows a subscriber for a large or small amount to secure the advantages of high grade securities, responsibility of competent management, and strength of investment provided by diversity:

The said Trustees shall hold all the funds and property now or hereafter held by or paid to or transferred or conveyed to them or their successors as Trustees hereunder in trust for the purposes, with the powers and subject to the limitations hereinafter declared, for the benefit of the holders of the certificates of beneficial interest in this trust. . . . .

The Trustees shall have as full power and discretion as if absolute owners to invest and reinvest the Trust Fund (including any surplus and also income) in personal property, including bonds, obligations secured by mortgage on real estate, notes and bank acceptances. . . . .

They shall have the like power of investment in securities of the United States of America, or of any state, county, municipality or town therein, or of any foreign government or of any state, city or subdivision of any government. . . . .

The Trustees shall have full power and discretion to sell, exchange, transfer and convey from time to time, at public or private sale, any



part or all of said Trust Fund upon such terms and conditions as they see fit, and the purchaser from them shall not be responsible for the application of the purchase money, and to invest the proceeds in the same manner and upon the same terms as the original fund. . . .

The Trustees shall also have power at any time to borrow money, and to pledge, as collateral security for such loan, any personal property belonging to the Trust Fund, provided, however, that no loan shall be contracted for, so that the aggregate amount of such loans outstanding shall at such time exceed, in the judgment of the Trustees, twenty-five per cent of the total amount of the personal property of the Trust Fund. . . .

**Importance of Investment Trusts in the Securities Markets.**—It may be useful now to summarize the various services which investment trusts render in supporting the securities markets, both at home and abroad, and in mobilizing savings for the purpose of encouraging sound investment.

1. They invest their own funds in securities which they intend to hold, at least for a season, in their portfolios (see Chapter V).

2. They sell securities from their portfolios when markets are buoyant, reinvesting their original capital and a part, or all, of their gains on realization, when markets are depressed, or in securities selling at less than their underlying value. In thus readjusting their portfolios to provide higher yields and to take appreciation profits, they tend to steady stock exchange fluctuations and to reduce the average spread between market prices of securities and their intrinsic worth. The rank and file of investors and marginal speculators are continually tempted to act in exactly the opposite way, viz., to drive securities to dizzy heights when markets are rising, and to "unload" on a falling market (see Chapter VI).

3. They have often been able, especially in Great Britain, to acquaint their own shareholders with the merits of particular issues which the latter may wish to purchase for their own account.

4. They direct public attention to investment opportunities

in certain areas, industries, and types of security, and instill public confidence by their own pioneer purchases.

5. They facilitate the underwriting and issuing of sound securities (see Chapter V) and give stability to new issues of the better sort. This applies particularly to British investment trusts, as in the United States investment trusts have not as a rule yet entered the underwriting field.

#### **Advantages of the Investment Trust to the Investor.—**

The investment trust therefore illustrates the saying that "In Union there is Strength." In England and Scotland, for instance, numerous companies of this character have long stood as intermediaries between home investors and foreign undertakings, permitting the uninitiated to acquire thus indirectly overseas "industrials" and "governments," and to place his "eggs" in more than one "basket," even though, strictly speaking, he has only one "egg." The accumulated funds of moderately circumstanced investors are placed to advantage in securities too costly for the average individual, either because the market price of each unit is prohibitively high, or because purchase may be made advantageously only in larger lots. Such co-operative buying in the financial world tends to reduce the overvaluation of "gilt-edged" and "trustee" securities by enabling the small capitalist more consistently to sustain new enterprises and quasi-speculative undertakings, and to meet demands for funds which, coming from regions less abundantly supplied with investment capital, offer a premium out of proportion to the additional risk involved.

In other words, the investment trust is a means of affording expert direction at small cost in the use of investors' funds, and the managers of a well-conducted trust bear their share of responsibility in discouraging the social waste of capital. Some of the British trusts have been large enough to maintain foreign advisory committees, offices, or agents, and all but the smallest of them have in their managing director, or secretary, and his

staff, a force competent to analyze critically any proposed investments, whether foreign or domestic. Their directors are men of affairs who give the trusts the benefit of their experience, and often open to them the same lucrative opportunities for participation which they have found personally profitable. Such arrangements have in the long run proved mutually advantageous in the United Kingdom, as they permit capitalists with investment trust affiliations to carry in their group a larger assignment of securities of unquestioned merit, perhaps at a time when the less informed cannot appreciate their true value.

**A Guardian of the Small Investor's Interests.**—Moreover, in the process of investment, at home and abroad, there are continually arising problems with which the individual stockholder cannot cope. A government defaults principal or interest; an enterprise is being reorganized; floating debts are funded and watered stock written off; a firm is going into receivership; policies are being pursued by a careless management which will ultimately harm stockholders or even the owners of senior securities. In times of political disturbances or trade depression, the power of trust companies in defending the interests of their shareholders is immeasurably greater than any action taken by isolated groups. To quote a prominent British investment trust executive:

Trust companies are frequently called into conferences in early stages in connection with capital issues, reorganizations or other matters affecting investors' interests, whereas the individual investor is usually faced with a *fait accompli*, and also, again, is frequently given insufficient time for proper investigation of matters affecting investments.

Furthermore, the vigorous steps often taken by investment trusts to protect minority stockholders, while usually directed to their own interests, make them a nucleus of protection for the small investor.

The following editorial quotation from the *Financial News* (London), of July 7, 1924, is suggestive of sound developments along this line :

Realizing the obstacles to action by certain classes of trustees for loan capital, we suggested in our article in March last that the trust companies might consider the question of co-operation, and form a corporation on the lines of the Corporation of Foreign Bondholders to undertake more generally the business of trustees, and to move where the circumstances of a case seem to demand action. . . . Our main object was to secure that the large trust corporations who are interested either as trustees, or are investors themselves in industrial undertakings, or who might be referred to, should exercise a greater influence in the direction of protecting the rights of different classes of shareholders or debenture-holders where those rights are assailed knowingly or threatened thoughtlessly. . . . Action by leading trust corporations, such as we see today, is all to the good, for, in the case of a reorganization of capital, they will endeavor to secure an equitable adjustment as between class and class, and will maintain confidence that might otherwise be lost.



## CHAPTER II

### LEGAL STATUS OF AMERICAN INVESTMENT TRUSTS

**Corporations and Common Law Trusts.**—It has been observed in the preceding chapter that the term “investment trust” has economic, rather than legal, significance. Organization of such undertakings may be effected in the United States under the corporate form, or as common law trusts, decision in any case depending upon such practical considerations as are set forth in the following paragraphs.

The investment trusts of England, Scotland, and the Continent, are for the most part corporations, while those of the United States are well represented by some ten trusts, of which seven are corporations (two of Delaware, one of Massachusetts, three of New York, and one of New Hampshire) and three are Massachusetts common law trusts. But the particular legal structure which expediency suggests does not fundamentally affect either their purposes or their methods. As they are merely processes of co-operative buying and handling of securities, carried on by trustees on behalf of the associated investing beneficiaries, the same results are attained whether the former are technically the directors of a corporation, or trustees in the restricted legal sense; and whether the latter are stock and bond owners, or holders of trustee certificates and obligations.

Chapters XIII to XVI, which broadly trace the development of investment trusts in the United States, illustrate both the corporate and the common law trust form of organization. Federal and state laws are sufficiently liberal, as they now stand, to permit the operation of such associations under varied legal forms affording reasonable safeguards for investors, and ample discretion to the directors, or trustees. As the Federal laws,

and those of the states, vary considerably, and as, in any event, counsel must be taken before decisions are reached regarding the legal structure of any particular undertaking, it will suffice to outline rather briefly at this point the principal jurisdictions under which investment trusts may operate in the United States, and the character they may assume.

**Common Law Trusts Described.**—The investment trust may be operated as a common law trust, just as almost any other type of business may be conducted in this way. Trust estates in business are common enough in New York, as is shown by the volume of relevant cases coming before the appellate courts. In that state, in Massachusetts, and in other states, a diversified range of purposes has been pursued under the common law or "business trust," as, for instance, buying, selling, and improving real estate; owning and disposing of patent rights; conducting general manufacturing, and mercantile business; operating plantations, mines, and public utilities; and holding shares in street railways, and in submarine cable companies.<sup>1</sup> Employed for over a half a century in New England, the use of this legal form is now spreading to many other parts of the country.

Students of the trust problem in America will also recall that the trust was the predecessor of the holding company in effecting early monopolistic combines in the oil, sugar, and other fields which early exhibited tendencies toward the elimination of competition. In fact, the activities which can be conducted through business trust estates may be considered as embracing practically the entire range of lawful purposes which actuate individuals in the exercise of their broadest rights to gain a livelihood; but close attention should nevertheless be paid to the rulings, court decisions, and statutes of each state before apply-

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<sup>1</sup> In a study by Harold Vesey Snyder of the University of Illinois on "Adapting the Legal Form of Organization to a Business Enterprise," there are cited, as among other examples of business trusts, the Mackay Companies, controlling the Postal Telegraph System; the Chicago Elevated Railway; and the Massachusetts Gas Companies.

ing so sweeping a generalization to any particular commonwealth.

**Legal Conception of the Trust.**—Technically, a trust may be defined as a right of property, real or personal, held by one party for the benefit of another. Legal decisions have laid down the principle that the title rests in the trustees, who conduct the affairs of the trust as principals rather than agents, and who are bound to account to the shareholders according to their respective interests, after the debts of the association have been entirely settled. The business of the trust is transacted upon the common law right of contract. The terms of the instrument establishing the trust, and defining the rights, liabilities and duties of the trustees can generally be framed with considerable freedom, and provisions of management may be amended with latitude as experience proves this desirable in the conduct of its affairs.

**Legislation Affecting Common Law Trusts in the United States.**—Trusts in one form or another having been a factor in business for several centuries, there are on record, as mentioned before, a great number of court decisions affecting them. With a few exceptions these have been favorable, or at least not adverse, to such common law forms of private enterprise. Among all the American states, in fact, only Massachusetts and Oklahoma have attempted to give more precise statutory definition to the implied status, rights, and limitations of trusts. The Massachusetts trust is the most common form; and the largest purely investment trust operating in the United States (the International Securities Trust of America) has been organized under the jurisdiction of that State (see Chapter XV).

**Massachusetts Trusts.**—Massachusetts trusts were originally organized to deal in real estate because the laws of that Commonwealth did not allow corporations to do this. At present they serve a wide variety of purposes, and may be

readily adapted to the investment trust idea. The important features of the Massachusetts trust are as follows:

1. A deed, or declaration of trust,<sup>2</sup> drawn up to define the rights and powers of the trustees and shareholders.
2. The assumption of responsibility by two or more trustees, who are authorized to take over and manage the capital, business or property supplied by the shareholders.
3. Provision for the issuance to shareholders of transferable certificates representing their respective interests in the current profits, and their proportional claims to the equity upon dissolution of the trust.
4. Definite agreements respecting such matters as division of profits, appointment of trustees to fill vacancies, and methods of dissolution when the trust is terminated.

Further information regarding Massachusetts trusts will be found in Appendix E, in which the tax problems affecting them, as well as trusts in general, are set forth in some detail.

**Trusts Compared with Corporations—I. CAPITAL AND CONTROL.**—From the foregoing it will be observed that there are many striking similarities between the trust and the corporate form of organization. The share, or certificate, holders of the former may be compared with the stockholders of the latter. The declaration, or agreement of trust, of the former is equivalent to the charter or certificate of incorporation of the latter. The trustees in the one case, and the directors in the other, represent the real owners in the appointment of the usual officers and the general direction of policy.

**2. ACCOUNTABILITY OF DIRECTORS.**—The instrument establishing the trust specifies whether the certificate holding beneficiaries annually elect the trustees; only fill vacancies arising among trustees originally appointed to hold office for the life of the trust; or waive practically all control in the ultimate management of the trust's affairs. Thus the relationship be-

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<sup>2</sup> For a complete declaration of trust of a Massachusetts trust see Appendix C.



tween the trust and its shareholders may be like that of the ordinary corporation and its owners, or it may be quite different; but in any event the trustees are legally and morally bound to administer the business in strict accordance with the trust agreement, and rights in equity attach to the beneficiaries, share or certificate holders (*cestui que trust*) requiring of the trustees faithful performance of their duties.<sup>3</sup> As a rule, the shareholders of the trust have the right of accounting and full information at all times in their dealings with trustees, provided, however, this information is not sought for improper purposes.

3. MARKETABILITY OF SHARES.—The trust also approximates most of the economic advantages of the corporation. Trust certificates, which are transferable on the books of the trustees, are not unlike corporate shares, with their convenient denomination, potentially wide market, and ready negotiability. As for corporation securities, the ease with which trust certificate owners may dispose of their holdings or effect collateral loans upon them will depend upon the earning record of the trust and its reputation in the community. Although trust shares are not likely to be extensively dealt in on the exchanges, there seems no good reason why they should not qualify as readily as corporation issues, if the size of the trust or the wide distribution of its ownership rendered this desirable; while sight must not be lost of the fact that many securities enjoying good dividends are unlisted, and do not suffer in public estimation because of this circumstance.

4. BORROWING POWERS.—In fact, the trust is in position to issue the same kinds of securities as the corporation, including all varieties of common and preferred stock. Like the corporation also, but always subject to the limitations imposed in

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<sup>3</sup> "As the strict relation of trustee and *cestui que trust* must never be forgotten nor derogated from, it has been sought to stress the necessity of there being a complete devolution of the legal title in the trustee and his absolute right, so far as third persons are concerned, to control the trust estate for all purposes within the scope of the trust instrument and bind it by his acts and contracts, the principles of equity governing his responsibility to his *cestui que trust*." (Sears.)

its declaration of trust, it may borrow on its short-time notes, and incur bonded indebtedness of any type. As creditors enjoy considerable rights in checking up the "trust fund," and as the supervision of courts under which common law trusts operate facilitates their claim against trustees individually in cases of fraud, it does not appear that such creditors, if they are reasonably prudent, lack adequate protection.

5. LIMITED LIABILITY.—To carry the analogy further, it may be noted that as compared with the limited individual liability of stockholders in a corporation, the beneficiaries of a Massachusetts trust are not personally liable with respect to its management or operations, and that this freedom from personal liability in tort and contract exists irrespective of the number of certificate holders, or beneficiaries constituting the *cestui que trust*.<sup>4</sup> The trustees themselves, being principals and therefore, technically speaking, personally responsible for claims arising in the course of the trust's activities, have nevertheless the right to limit their own liability in the declaration of trust and in specific contracts; and creditors are thereby deprived of recourse other than to the trust estate itself, save that in cases of fraud on their part the trustees are, of course, individually liable. The latter may act with an informality resembling that of partners, or with the formality of a corporate board of directors, but their status and responsibilities disclose how much more closely the common law trust resembles the corporation than the partnership.

6. PERIOD OF EXISTENCE.—As touching the terms of legal existence of the corporation and the trust, the differences are rather of technical than practical importance. Whereas the corporation receives a perpetual charter, or one limited to a certain

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<sup>4</sup> The following is quoted from the monograph on "Adapting the Legal Form of Organization to a Business Enterprise" by Harold Vesey Snyder: "The Massachusetts trust has the advantage of the members' limited liability which the members of a joint-stock company do not have. In a joint-stock company, even if the legal title is invested in trustees, the shareholders are proprietors, and liable in tort and contract as principals. A joint-stock company has been described as an 'overgrown unwieldy partnership,' which may be the case, but in any event, it does not have the simplicity of operation possessed by a Massachusetts trust."

number of years and afterwards renewable during good behaviour, the trust may be constituted for an indefinite period, for the term of life of specified persons, or, in some states, for twenty years or more after the death of the last surviving creator. In more than one way, therefore, the trust does not suffer from the commonly assumed drawbacks of the partnership, and affords, in fact, most of the positive advantages of the corporation.

**Factors in the "Trust" Movement.**—The common law trust was, a few decades ago, a most effective means for restraining competition, and as forerunner of the holding company, which in general set-up resembles an investment trust, but which has proved a potent handmaiden of monopolistic combination in the United States, it is largely responsible for the unsavoury popular connotation of the word "trust." Trust agreements of the type under which the Standard Oil (first in 1879 and again in 1882) and the sugar refining interests were originally merged—to mention but a few precursors of the twentieth century "trusts"—might well have been among the most common forms of business consolidation today were it not for the adverse action of the highest New York court which pronounced as *ultra vires* in the case of any corporation concerned the surrender of control of hitherto competing companies to a group of "trustees," and revoked the charter of a corporation (the North River Sugar Refining Company) whose shareholders thus permitted it to be "bound and gagged." The supreme courts of Ohio and Louisiana also assumed a hostile attitude toward the "trusts." These early adverse decisions do not affect in the least the investment trust, whose shares are generally sold for cash and not exchanged for stock, and whose *raison d'être* is diversified investment, and not the strangling of competition by a grouping or even an assumption of control.

The holding company became in its turn the most widely used means of quasi-monopolistic control until the Supreme

Court decisions in 1911 ordered dissolution of the Standard Oil and American Tobacco combines. The holding company, permitted under the laws of several states, was used as the corporation equivalent of the common law trust by clever lawyers, who sought in this way to circumvent increasingly hostile state and Federal legislation. Here, again, the unfavorable attitude of courts and lawmakers in the United States, which has resulted in a pronounced movement toward outright merger, or consolidation, does not at all affect the legal validity of any investment trust operating under corporate charter. The holdings of an investment trust, including a wide variety of diversified securities, show nothing remotely approaching control in any one of the numerous undertakings whose stocks or bonds may have been purchased in the normal course of prudent investment.

**Investment Trust Incorporation.**—It is probable that the majority of American investment trusts will be organized as corporations under the business incorporation laws of the several American states. The greater familiarity of the investing public with the corporate type of enterprise, the dominance of corporate issues in the stock exchanges and their somewhat readier negotiability, the greater publicity under which corporations generally function—all of these and other factors have given rise to comparative hesitancy on the part of the average buyer in purchasing shares of common law trusts. If an investment trust merely represents co-operation among a limited number of interested investors, there are many things to be said in favor of the non-corporate form; while from certain points of view suggested in the concluding paragraphs of this chapter it may be more advantageous than incorporation. Nevertheless, the probability is that a wide appeal will be made in the sale of investment trust securities, and that in order to facilitate their broad distribution a type of organization will be employed which is familiar to the rank and file of investors.



**Three Ways of Incorporating American Investment Trusts.**—Investment trusts may be incorporated in the United States (1) under the Edge Act; (2) under the general laws of business incorporation of the several states; and (3) in certain instances, under the state banking laws, or the special statutes relating to investment companies. These several means of incorporation will be briefly considered.

**The Edge Act.**—Since the adoption of the Edge Act in 1919 (Section 25a of the Federal Reserve Act), it has been possible to organize investment trusts under national charters of incorporation, although little practical use has as yet been made of these permissive sections of the law. A complete statement of the provisions of the Edge Act, with all the administrative regulations relating thereto issued by the Federal Reserve Board, appears in Appendix F, but the law is of sufficient importance to warrant, at this point, a résumé of its outstanding features.

1. Corporations may be formed “for the purpose of engaging in international or foreign banking or other international or foreign financial operations, or in banking or other financial operations in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries or in such dependencies or insular possessions.”

2. Capital stock of at least \$2,000,000 is required. The stock must have par value; and before business can be commenced, each shareholder must individually have paid in cash at least 25% of his stock subscription.

3. Edge law corporations may engage (a) in long-term financing, by investing in obligations or in the stock or other certificates of ownership of corporations engaged in foreign business (to an extent not exceeding 15% of their capital and surplus in banking institutions and not exceeding 10% in business undertakings) and by offering foreign securities for sale;

or (b) in short-term financing, by engaging in the several phases of the acceptance business in connection with the import and export of goods.

4. Edge law corporations may issue debentures, bonds, and promissory notes as an added means of financing their foreign activities, but the aggregate of the corporation's liabilities outstanding "shall not exceed at any one time ten times the amount of the corporation's subscribed capital and surplus except with the approval of the Federal Reserve Board."

5. In application of the permissive provisions outlined in (3) and (4) above, the Federal Reserve Board has ruled "that, except with the approval of the Board and subject to such limitations as it may prescribe, no corporation shall exercise its power to accept drafts or bills of exchange if at the time such drafts or bills are presented for acceptance it has outstanding any debentures, bonds, notes, or other such obligations issued by it."

EDGE ACT USED MAINLY FOR SHORT-TERM FINANCING.—The effect of this ruling has been to differentiate clearly between the acceptance and the long-term financing types of activity; and virtually to restrict any Edge corporation to a characteristic acceptance, or bond form of liability. The two institutions which to this time have operated under the Edge Act <sup>5</sup> have chosen to engage in the acceptance business, and to operate primarily in the discount market in connection with financing the requirements of foreign trade. Neither of them is in any sense an investment trust, although a recent ruling of the Federal Reserve Board, permitting the First Federal Foreign Banking Corporation to make a limited issue of debentures, perhaps foreshadows a gradual entrance into this type of business as ancillary to the main purpose of short-term financing.

It would be rash to prophesy the importance of the Edge

<sup>5</sup> The First Federal Foreign Banking Corporation of New York; and the Federal International Banking Corporation of New Orleans. Both have now gone out of existence.

Act in the development of investment trusts; but there seems no doubt that the prestige of Federal incorporation, coupled with the liberal provisions of the Federal banking laws permitting subscription to the stock of organizations functioning under the Edge Act,<sup>6</sup> will be strong factors favoring incorporation of long-term financing companies under the above-mentioned law.

**LIMITATIONS AND DEFECTS OF THE EDGE ACT.**—The Edge Act, however, is by no means an ideal statute, and a few limitations which it imposes may have to be somewhat modified if the competition of state incorporation laws in the organization of investment trusts is to be successfully met. With the line of demarcation between acceptance, and investment and long-term financing activities, there can be no complaint, because this accords with sound economic policy. But the Edge Act, like the national banking laws, is lacking in the breadth and liberality which, in certain directions at least, characterizes the statutes of several states.

1. *High Minimum Initial Capital.*—The minimum initial capital specified for Edge law corporations is greater than necessary for the launching of a successful investment trust, for it should be borne in mind that mere size is not a criterion of success, or even an assurance of the most economical management of the capital account. Investment trusts, not being primarily promoting companies, generally grow slowly, increasing their capital in the measure in which public confidence is gained. It would seem desirable that the investment trusts should keep certain securities "on tap," judiciously investing such funds as are raised in this way from the general public. Ultimately such policies would prove a great encouragement to thrift, and do much to increase care in investment. The more conservative the beginning, the more success-

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<sup>6</sup> The Federal Reserve Act was amended in September, 1916, to permit national banks having capital and surplus exceeding \$1,000,000 to purchase and hold capital stock in American banks or corporations chiefly interested in foreign banking, to an amount not greater than 10% of their own capital and surplus. The McLean Act, of September 17, 1919, authorized any national bank, regardless of size, to invest in Edge corporation stock up to 5% of its capital and surplus.

ful the company in many instances, because heavy initial commitments are thus discouraged, and operating capital is only increased as occasion warrants. There is in fact no other kind of financial business in which the parable of the talents is more forcibly applicable. In view of the very small minimum size required of national banks, there is no valid reason for maintaining a minimum capital of \$2,000,000, at least for the investment trust type of Edge law corporation.

2. *Financing Companies Rather than Investment Trusts Contemplated in the Edge Act.*—The framers of the Edge Act probably contemplated primarily a promoting or financing kind of investment trust. They were eager to facilitate American exports by arranging long-term financing, and by encouraging the development of active agencies for the foreign penetration of American capital, accompanied by American enterprise. Hence the Act provides for investment, under certain limitations, “in the stock, or other certificates of ownership,” of banking or business corporations. It is apparently expected that the investments in common shares shall constitute in many instances a majority control, savouring of the portfolios of continental banks and of European financing trusts (see Chapters XII and XIII).

The provisions of the law seem sufficiently elastic, however, to permit also of investment trust business in the broader sense<sup>7</sup>. As in all probability there will be ample opportunity for American companies combining financing and investing activities, and for undertakings emphasizing one or another type of investment trust policy, it is well that the Edge Act thus authorizes in general terms that which might otherwise be questioned. Certainly bonds and other obligations should be purchasable, especially if the concentration of control through

<sup>7</sup> From Section XV of Appendix F: “. . . a Corporation may exercise abroad . . . also such incidental powers as may be usual in the determination of the Federal Reserve Board in connection with the transaction of the business of banking or other financial operations in the countries in which it shall transact business. . . .”



stock acquisition is permitted within certain limits (see Section IX, Appendix F).

3. *Limitation to Foreign Activities.*—The long term financing sections of the Edge Act not only provide for the incorporation of financing investment trusts, but also specify that these companies shall engage primarily in foreign business. This is a great drawback to the present incorporation of investment trusts under Federal law, for there is every reason why such institutions should be considerably, perhaps even primarily, interested in domestic securities. The principle of distribution of risk, which is bedrock investment trust policy, requires a considerable portfolio of American dollar domestic issues, especially in these days of fluctuating exchanges and unbalanced budgets; while no well-informed banker would advise his clients generally to avoid domestic in favor of foreign issues, on the score either of safety or return.

4. *Dangers of Over-borrowing.*—If the Edge Act is not liberal enough in some particulars, it would seem to be too liberal in others. Certainly the most ardent promoter cannot complain of the Federal Reserve Board regulation that the aggregate liabilities of an Edge law corporation may reach a maximum figure of ten times its subscribed capital and surplus, and even go beyond that limit with the express permission of the Board. This means that a bond issuing investment trust could borrow on debentures many times the equivalent of the sums furnished by its owners. So high a ratio of borrowing is unsound investment trust policy; it deprives creditors of their proper margin of protection and renders the position of the company comparatively unsafe through the piling up of fixed charges.

The investment trust is principally co-operative buying of securities. If the shareholders desire to increase the amount of net distributable income by borrowing at rates less than the average yield on their portfolio, it is sound policy for them to

do so; but they should not borrow to such an extent that the portfolio largely represents the placing of capital belonging to creditors. The British investment trusts rarely borrow from all sources more than the equivalent of their subscribed capital; while those Continental financing investment trusts and banks which will be examined in detail in Chapter XII, issue comparatively few bonds, or confine their long term investments to an amount not greater than their capital and reserves, as the case may be. Most American investment trusts (Chapter XVI) operate under strict borrowing limitations, if they borrow at all; and similar restrictions will probably commend themselves in the future.

#### **Incorporation of Investment Trusts under State Laws.—**

It has been noted earlier in this chapter that investment trusts may be organized under the general corporation acts of the different states, and in at least a number of commonwealths, under the banking laws. A detailed exposition of the standards from state to state would involve an enquiry far transcending the limits of this book, and the reader who wishes a more comprehensive view than his lawyer might give him needs only to pore over the standard reference works on the subject, like the Corporation Manual, published by the United States Corporation Company. The ordinary business incorporation laws of such states as New York and Delaware, to mention only a few, are unquestionably broad enough to embrace all the activities of the typical investment trust; but careful consideration should be given in any particular case to the relative advantages offered by the laws of the several states.

As receiving deposits and paying by check are not ordinarily classed among investment trust activities the organization of such companies need not be under the banking laws, or subject to the supervision of the state authorities concerned therewith. Nevertheless, the prestige which in some states attaches to incorporation under the banking laws, and the confidence instilled

in the investor by a semblance of closer public supervision, may well outweigh the extra effort or expense involved in obtaining it. In the New York State banking law, for instance, "investment companies" appear as one of the six categories which may be incorporated under its provisions. As no business may be transacted until all of the capital stock has been paid in cash and a surplus accumulated, and as reports must be sent to the Superintendent of Banking, there is in the public mind a certain prejudice in favor of financial companies so incorporated. "Investment companies" operating under the New York State banking law enjoy, in addition to the powers conferred in the general corporation law, the right, under prescribed limitations, to undertake a deposit and lending business.

### **Comparative Advantages of Trust and Corporate Form.**

—There remain to be considered a few other general circumstances which should be weighed in determining the legal structure of a proposed investment trust.

#### **I. TAXATION AS APPLIED TO TRUSTS AND CORPORATIONS.**

—The question of taxation is a highly technical one, and the attention of the reader is directed to a résumé of the situation as affecting trusts, which appears as Appendix E. It is enough to call attention at this point to the different treatment accorded in the Revenue Act of 1924 to corporations or "associations," and "trusts." Whether or not a common law trust is so classified for Federal taxation purposes depends, as explained in detail in Appendix E, upon the degree of control which the trust instrument vests in the beneficiaries, or shareholders; and upon the nature of business—whether merely holding and managing investments (holding trusts), or carrying on some active enterprise (operating trusts), which the trustees transact for the beneficiaries.

In all probability investment trusts operating as common law trusts and widely marketing their securities would be so organized and managed that they would be treated as "associa-

tions" for most Federal taxing purposes. If not classed among "associations," or "corporations," within the meaning of the law, the trust is, of course, not liable to the normal Federal and state taxes on corporation income, or to the Federal capital stock taxes; but, as in the case of partnerships, Federal and state taxes are nevertheless payable on income—whether distributed or undistributed—which is in either case regarded as belonging to the beneficiaries. The important preliminary step is to study the appropriate rulings to determine under which category the proposed trust would probably come, and when this is done to consult a tax expert for estimating the probable aggregate taxes under each feasible plan of organization. These aggregate taxes would be affected by the surtax brackets in which the income of the individuals falls, and the rates of tax which the future acts may levy on corporations and individuals, respectively. It is also of importance to bear in mind that franchise taxes are not levied on Massachusetts trusts except by the state of their domicile.

2. FLEXIBILITY OF THE COMMON LAW TRUST.—The trust, carrying on its business under the common law right of contract, is free from those statutory exactions to which the corporation is subject as an artificial person and creature of the law. Reports are not required; and in many states the trust is not compelled to qualify in order to do business, as is a "foreign" corporation, for it enjoys in these respects practically the freedom of the individual.

On the other hand, trustees are privileged to apply to the courts for guidance in executing their trust, and any directions which the courts may wish to give generally involve in advance an assurance of legality to acts resulting therefrom. Moreover, liquidation and winding up are considerably facilitated when, under express provisions of the trust instrument, any termination of the trust may be carried out without resort to tedious and expensive legal proceedings. In brief, trust estates,



where otherwise desirable or possible, do seem to afford stability consistent with sound business policy in times when changing public opinion finds expression in a confusing mass of regulatory and inhibitive acts.

3. ATTITUDE OF THE PUBLIC.—Although the common law trust possesses some advantages, other things being equal, in matters of taxation and control it does not command public confidence to the same extent as the corporation. The corporate form being far more widely used, and the benefits of corporate organization much more generally understood, the raising of capital may encounter greater obstacles under the trust form.

4. TRUSTS AND CORPORATIONS UNDER THE "BLUE SKY" LAWS.—Despite the fact, cited above, that in many states the common law trust is allowed to do business as freely as an individual, it must not be assumed that these enjoy any advantages over corporations with respect to the application of the "Blue Sky" laws to be found in an increasing number of American states. In fact, rather the contrary is the case.

In eight commonwealths (Arkansas, Illinois, Iowa, Kansas, Kentucky, Michigan, California and Missouri) shares in trusts have been declared subject to approval by state authorities, as in the case of corporate issues, before public sale is permitted. As far as the writer is aware, Oregon is the only state having a "Blue Sky" law in which a business conducted under a trust agreement has been considered outside the jurisdiction of the commission regulating the sale of securities. In this case, however, it was ruled by the State Supreme Court that a common law trust does come within the statutes governing trust companies; as these laws require a "foreign" company transacting a trust company business to conform to all the requirements of the law relating to Oregon trust companies, the common law trust enjoys no immunities by its technical exclusion from the scope of the "Blue Sky" laws.

Particularly interesting in this connection is the attitude of the state of Illinois, which has ruled that a sale of shares in a business or trading trust in violation of the Illinois Securities Law is void, and that notes given therefor are unenforceable. The aforesaid law classifies trusts as corporations in all regulations pertaining to the marketing of securities. The attitude of the authorities in this state seems to have been generally unfavorable to the wide marketing of shares in trusts, and in only two or three exceptional cases has permission been specifically granted to sell such securities publicly under the provisions of the "Blue Sky" law.

Further evidence of the disfavor under which common law trusts find themselves in certain states may be seen in an opinion of the Attorney General of Ohio "that a voting, unincorporated association formed for the purpose of acquiring property to be held by a trust in conducting a multitudinous and almost unlimited line of business is opposed to the public policy of the state," and in a recent ruling of the Supreme Court of Washington that the common law trust is without legal standing in that state.<sup>8</sup>

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<sup>8</sup> The State of Washington, on the relation of *J. W. Range, et al., Plaintiff, v. J. Grant Hinkle, as Secretary of State, Defendant*, October 4, 1923.

## CHAPTER III

### THE STRUCTURE OF INVESTMENT TRUST CAPITAL

**Three Types of Securities Issued.**—Having studied the legal forms under which investment trusts may function, we are now in position to consider the means employed for raising their capital. Like ordinary business corporations, investment trusts offer the public three principal kinds of securities—common stock, preferred stock, and bonds; and in analyzing the several varieties of each an attempt will be made to explain the ratios ordinarily obtaining between them.

#### Common Stock

The starting point must, of course, be capital raised by the placing of common stock. Some investment trusts, in fact, both in England and the United States, have only common stock outstanding, but this is emphatically the exception among companies long enough established to prove their borrowing power. In the case of stock conversion and similar companies, described in Chapter XIV, which in some ways resemble investment trusts, and are often popularly referred to as such, capital is raised solely by the issue of the common shares, or participating certificates, and the nature of the express trust underlying them prevents any exercise of borrowing power.

Several American investment trusts, acting purely as mutual investment associations on behalf of their shareholders, have provided merely for the issue of common stock, or shares of beneficial interest. The Massachusetts Investors Trust (see Chapter XVI), for instance, offers one class of common stock, and no bonds or preferred stock, the income being derived from dividends and interest accruing on investments purchased with

the shareholders' money and deposited in a Boston trust company. Similarly, the Bond Investment Trust (see Chapter XVI), also a Massachusetts common law trust, issues only "certificates of beneficial interest." The Investment Managers Company, which is described in its circulars as a "Joint Stock Association organized to manage Investment Funds for the benefit of the holders of Investment Trust Certificates representing beneficial interests in such funds," issues such certificates in alphabetical series under an indenture providing, among other things, that "No money may be borrowed, through the issuance of debentures or otherwise, against the securities held in the Investment Fund."

As the investment trust certificates issued by the above-mentioned company present some unusual features, the following description of them is quoted from a recent prospectus :

#### INVESTMENT MANAGERS COMPANY

##### Investment Trust Certificates, Series A

Each subscriber to the Investment Fund created by Investment Managers Company under the Investment Trust Indenture dated as of January 1, 1925, will receive an Investment Trust Certificate, Series A, constituting a contract between the registered holder, Investment Managers Company and the Trustee, under which the Company for a stipulated charge, undertakes the management of the Investment Trust Fund, for the benefit of the Certificate Holders, and setting forth :

- (1) That the registered holder has paid into the Investment Fund a stated sum equal to the face value of his Certificate.
- (2) That the registered holder is the owner of a stated number of shares in the Investment Fund, being the number that the amount of his subscription entitles him to receive on the day that the Certificate is issued, based on the actual value of the Investment Fund at that time.
- (3) That out of the net income derived from dividends, interest, etc., on the Investment Fund, the registered holder is entitled to receive distributions at the rate of 5% per annum on the face value of his Certificate, from the date of issue, payable quarterly on the 15th day of January, April, July and October.



- (4) That after the end of each calendar year the registered holder is entitled to receive an additional distribution, hereinafter described, out of his proportionate part of all income derived from the Investment Fund in excess of the 5% distribution on the face value of the Certificates.
- (5) That the registered holder may redeem his Certificate and receive its actual value, at the option of the Company, either (a) in cash or (b) in a proportionate part of each of the investments held in the Investment Fund, with adjustment of fractional interests.

Through his right of redemption the Certificate Holder retains control over his share of the assets in the Investment Fund, including reserves accumulated during the period his Certificate has been outstanding. Certificates are not transferable.

The redeemability of these certificates distinguishes them clearly from the usual type of common stock and makes them in one respect akin to the "bankers shares" of stock conversion trusts mentioned above. However, the fact that the Investment Managers Company, to quote from its "Investment Trust Indenture," ". . . shall have absolute control and management of the Investment Fund, except as herein otherwise specifically provided, and the Company shall cause the Investment Fund to be invested and reinvested from time to time as the Company may in its absolute discretion deem to be for the best interest of the Investment Fund," (although legal title is vested in the Trustee) prevents the certificates being so classed, and assimilates them to the broad category of investment trust certificates and common shares.

**Voting Rights of Common Stock.**—In the case of such trusts as those mentioned above, the rights of the common shareholders, or more accurately, the owners of beneficial interest, are necessarily more restricted than those of the possessor of ordinary deferred stock. Reference was made in the preceding chapter to the fact that Massachusetts common law trusts may be so created that the voting privileges vested in

shareholders are approximately as in corporations; while, if the creators of the trust prefer, they may make the trustees self-perpetuating and virtually limit shareholders' privileges to pro rata rights in distribution and liquidation. The Massachusetts Investors Trust, and the Bond Investment Trust are of the latter type. The "investment trust certificates" issued by the Investment Managers Company carry, of course, no rights in the latter, which is not itself an investment trust, but a company formed for the purpose of creating "investment funds," issuing certificates to the public, and managing the deposited investments. Holders of the certificates, however, have certain rights over the trustee, as defined in Article VII, Section 2, of the "Investment Trust Indenture":

The Trustee may be removed at any time by an instrument or concurrent instruments in writing signed by the registered holders of not less than fifteen per cent of the total Face Value of all Certificates then outstanding hereunder. In case at any time the Trustee or any successor thereto shall resign or be removed, or otherwise shall be incapable of action, a successor trustee may be appointed by the Board of Directors.

Practically all British, and a number of American investment trusts, as suggested earlier, have issued bonds or notes, preferred stock, or both, or contemplate such issues when markets are favorable or earning power has been demonstrated; and their common shares are similar to those of any business corporation. This applies for instance, in the case of the International Securities Trust of America, another Massachusetts trust, whose common shareholders are entitled to elect the trustees, and whose relationship to the enterprise so closely approximates that of shareholders in any corporation that for Federal Income tax purposes the trust is classed as an "association" (see Appendix E). The common stock of incorporated investment trusts, such as the Financial Investing Company of New York, and the Morristown Securities Corporation, carry the usual privileges. This is also true of the investment trusts

of Great Britain, most of which are incorporated and the great majority of which issue bonds as well as common and preferred shares.

**Par Value of Common Stock.**—These latter without exception attach par value to their shares, but the practice varies in the United States, as far, at least, as common stock is concerned. Among other American investment trusts, the following issue common shares without par value:

International Securities Trust of America  
First Investment Company of New Hampshire  
Morristown Securities Corporation

On the other hand, the following, among others, issue common stock of a parity varying from \$10 to multiples of \$100:

The Bond Investment Trust  
The Investment Managers Company (Investment Trust  
Certificates)  
The Massachusetts Investors Trust  
The Financial Investing Company

In the case of the British trusts stock is usually issued in units appealing to the investor of moderate means, and is as a rule transferable (both preferred and common) in sums of £1 and multiples thereof. Very easy conditions of payment are frequently offered at time of issue, providing for instalments over a period of several months.

**Practice of Splitting British Investment Trust Shares.**—A very interesting practice prevails almost without exception among the investment trusts of England and Scotland. This is the issue, initially, of “share” certificates, often in £10 denominations, which, when fully paid for, are converted into “preference” and “ordinary stock” in the ratio of 60% to 40%. Occasionally the “shares” are converted merely into denominations of common stock. Among recent flotations there have been a few (for instance, the Redeemable Securities Investment

Trust, and the Second Guardian Trust) in which the "shares" carried a par value of only £1, and were converted into common stock, but the British buyer of a new investment trust issue in most cases finds himself in the position of both preferred and deferred shareholder unless he chooses to sell one or the other type of stock into which his original share has been transformed.

It is generally assumed in the British Isles that such shares, representing definite ratios of common and preferred, constitute an ideal unit for the investment trust stockholder. By possessing preferred stock he enjoys a secure return on a portion of his capital, and as an owner of common he participates fully in the growing earning power of the trust. The share unit which, at time of writing, is being offered by the International Securities Trust of America resembles the typical "share" of these overseas trusts, as it is composed of one share of cumulative preferred and a half share of common stock.

From another point of view the issue of "split shares," or of stock units carrying preferred as well as common, seems only a logical means of enabling the investor, to the extent that he is a possessor of common shares, to profit from the trust's remunerative use of the fixed cost capital represented in his shares of preferred. If, for instance, the trust has no borrowed capital, but has issued common and preferred shares of equal denomination, at par, in the ratio of one to three, it is evident that there will be available for each share of the former not only the percentage representing a pro rata claim on net earnings (assuming only one kind of stock outstanding), but a further percentage, as well, which would be three times the difference between the former percentage and the rate of cumulative yield on the preferred.

### Preferred Stock

**Ratios to Common.**—While there are too few investment trusts in the United States and their history is too brief to make



generalizations useful, it is of interest to reiterate that the ratio of preferred to common stock obtaining among investment trusts of Great Britain is generally sixty to forty, or, less frequently, fifty to fifty. Most companies specify that their preferred stock shall not exceed 60% of the total issued share capital<sup>1</sup> and this above-mentioned restriction is in keeping with the conservative management typical of investment trusts. By reference to Section II of Appendix A the reader will see that in 1912 the average capital representing preferred stock in the leading British investment trusts was £411,000, and the total for sixty-five trusts analyzed was £26,000,000; ten years later, the average preferred was £441,000, and the total for seventy-seven trusts analyzed was £34,000,000. In the earlier year, and for the same trusts, the average capital raised by the sale of common stock was £346,000, and the total £21,000,000; in 1921, the average common was £415,000, and the total was £32,000,000. In other words, at the earlier period some 28% of the entire capital was in the form of common stock, approximately 34% was in preferred, and the remainder in debentures; in 1921, for the seventy-seven trusts analyzed in that year, the figures were 32, 34, and 34% respectively, a circumstance which shows how loath they are to accumulate fixed charges when costs of capital are higher than it has been their wont to pay in earlier days.

Capital is less commonly raised, among American investment trusts, by the issue of preferred stock. Several, however, including the International Securities Trust of America, and the Morristown Securities Corporation, follow British practice in this regard; and approximately \$3,425,000 of the entire capital of \$9,955,000 (March 1, 1926) raised by the former in the sale of its bonds and shares to the public (See Appendix D) represents the funds contributed by the preferred shareholders.

<sup>1</sup>American Trust Company; The Anglo-American Debenture Corporation; The Scottish and Dominions Trust; The Second Scottish Northern Investment Trust and others. The United States and South American Investment Trust Company declares that it shall not exceed fifty per cent of the total issued capital.

It is of interest in this connection to quote from a prospectus of the International Securities Trust of America which in the following words describes the restrictions under which preferred is issued:

INTERNATIONAL SECURITIES TRUST OF AMERICA

6½% Preferred Shares

The Preferred Shares are safeguarded by the assets of the Trust which consist solely of cash and investments. No Preferred Shares of the Trust may be issued unless the net assets (after deducting all indebtedness together with the Preferred Share Dividend Reserve Fund) taken at market value, shall equal at least 125% of the Preferred Shares outstanding and then to be issued; nor unless such net assets, taken at cost value, shall equal at least 133% of the Preferred Shares outstanding and then to be issued.

The Preferred Shares therefore comprise an investment protected by:

- (1) A distribution of funds among at least 400 seasoned, marketable securities (as described under "Standards of Diversification").
- (2) 125% (market value) of marketable securities.
- (3) A diversification of investment bonds and stocks selected under the guidance of statistical research, legal assistance and investment experience and opportunity not available to the individual investor.
- (4) Distribution of risk to the extent that for each \$100 invested in the Preferred Shares, an average of less than 25 cents is placed in any one security.
- (5) A Preferred Share Dividend Reserve Fund accumulating until equal to 10 times the annual dividend.

**Rates, Voting Powers, Participation Rights, and Redemption of Preferred Stock.**—Rates of dividend paid by the British investment trusts on their preferred shares, vary from 4 to 5½%.<sup>2</sup> Each one of the companies paying from 4 to 4¼%, was organized by the mid-nineties. About thirty British trusts pay 4½% on their preferred shares, and 5% is offered by

<sup>2</sup> For yield at current prices, see Chapter IX.

a small number. The majority of the former were incorporated by the late eighties, and the tendency is noticeable to pay higher rates since 1900. Six per cent on preferred stock is rarely found among investment trusts in Great Britain, although some financing companies offer this return. Numerous investment trusts have more than one issue of preferred outstanding, bearing different rates of dividend and marketed at different periods. The yield on preferred stock held by the American investor must probably be at least 1% higher than in the United Kingdom, where the lower rates of pre-war years and the privileged position enjoyed by investment trusts in the confidence of the public have operated to their advantage in expanding capital.

Preferred stock is generally cumulative, non-participating, non-convertible, and entitled to priority in event of winding up, but there are exceptions which prove the rule. Thus several British companies specify that the minimum rate on preferred stock shall be 4%, and that under given circumstances there shall be further participation not to exceed 5% in all. This is true of such companies as the British Investment Trust, The American Trust Company, and the Merchants Trust Company. An interesting provision is to be found in the by-laws of the First Investment Company in New Hampshire, which stipulate that the preferred ("Class A") stock shall be entitled to priority dividends of \$3 per share per annum, and to an equal participation in any further dividends with "Class B" (common stock).

Several American investment trusts make their preferred stock redeemable at the option of the issuer—in one case at par, in another at several points advance above its offering price at parity. Voting rights frequently attach to preferred stock of British trusts, for the reason that it represents a fractional part of the originally issued shares. A common provision is to the effect (to quote the prospectus of the Second Scottish National Trust Company, Ltd.) that "every member shall have one vote

for every Share held by him, and . . . when the shares are converted into Preference Stock and Ordinary Stock, every Member shall have one vote for each £10 of Preference Stock and four votes for each £10 of Ordinary Stock held by him."

In the United States, preferred stockholders of investment trusts, as of any business corporations, enjoy voting rights only when their dividends remain unpaid.

**"Preferred" and "Deferred Ordinary" Stock.**—In Great Britain there is occasionally to be found a variety of stock which, strictly speaking, is a cross between common and preferred, for common stock, while generally of one type, is occasionally divided into ordinary "preferred," and ordinary "deferred." The current difference between the two types is generally that the "preferred ordinary" is entitled to a dividend somewhat higher than that offered the preference stock, payable as a second lien on profits. It is not cumulative, like the preference stock, nor participating to the same extent as the "deferred ordinary." The most important distinction, however, is the lien which each type of stock has on the company's equity in the event of winding up. The order of precedence, after debenture holders are satisfied, would be preferred, preferred ordinary, and deferred ordinary. One British company, for instance, issues preference shares entitled to a cumulative dividend of 6% and to priority for capital without further participation. Preferred ordinary is next entitled to a non-cumulative dividend of 7% and to priority for capital over deferred ordinary shares, but without further participation.

**Advisability of Issuing Preferred.**—There is ground for disagreement regarding the advantages of issuing preferred stock. No general rules can be laid down, as the advisability of such issue must be considered with reference to the peculiar circumstances in each case.

The disadvantages are that preferred stock complicates the capital set-up of a type of enterprise which, because it exists



primarily for the interests of the moderately situated investor, should be as readily intelligible as possible. Unless a reasonable redemption figure is covenanted, it may also saddle the trust with prior charges which appear extravagant when borrowing power is firmly established. Moreover, there is a sense in which preferred stock is neither "flesh" nor "fowl," in that it neither equals the investment trust bond for absolute safety, nor ranks with the common shares in participation rights.

The advantages are that, as in any field of business, the issuance of preferred stock increases the proprietary capital and thereby broadens the borrowing basis without at the same time appreciably endangering the common stockholders' control or introducing other claimants to their prospective profits. Moreover, when sold in units with common, preferred stock affords an ideal basis of public participation, as mentioned above, and the fact that preferred stock so issued is outstanding for practically all British investment trusts commends this practice to American consideration. If the trust is well managed, added returns can be made for the common shareholder by obtaining more capital than would be advisable by bond borrowing alone, at a cost, which, though yielding to the holder more than the bonds, is still advantageous for the trust.

### **Advantages of Investment Trust Borrowing**

Concerning the wisdom of exercising borrowing power to obtain additional capital at reasonable cost, there can be no doubt. This is a legitimate and universally accepted means of increasing the earning strength of investment trusts.

**Illustration Applicable to American Conditions.**—Reverting again to a simple numerical illustration, let us consider a trust whose capital has been raised by sale of bonds, preferred stock, and common stock, in the ratio of 5:3:1 respectively.<sup>3</sup> Bond capital, if allowance is made for marketing

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<sup>3</sup> This is the actual set-up of the capital of the International Securities Trust of America, although the illustration is not otherwise applicable to the Trust.

charges, might cost  $6\frac{1}{2}\%$ , and capital obtained through sale of preferred stock at least  $\frac{1}{2}\%$  more. Let us place the average net yield on investments, both domestic and foreign, at  $6\frac{1}{2}\%$ , and assume the profits on turnover, year in and year out, to approximate at least  $2\frac{1}{2}\%$ . Let us also provide for current administrative cost at  $1\%$  of the invested capital, thereby reducing the assumed net earnings to an average of  $8\%$  on the latter. The amount theoretically available for each share of common stock will then be:

1. The  $8\%$  earned directly on the capital provided by its holder, *plus*

2. The equivalent of  $1\%$  on the same (the difference between  $8\%$  and  $7\%$ , which represents in this illustration the cost of preferred capital) for each time that the capital provided by the common stock may be divided into the capital provided by the preferred (in this case, three times), *plus*

3. The equivalent of  $1\frac{1}{2}\%$  on the same (the difference between  $8\%$  and  $6\frac{1}{2}\%$ , which represents the assumed net cost of capital borrowed on bonds) for each time that the capital provided by the common stock may be divided into the latter (in this case, five times).

Theoretically, therefore,  $18\frac{1}{2}\%$  earnings<sup>4</sup> are made on the common stock, although wise management would dictate no such distribution in dividends, but would allocate to reserves a substantial proportion of the net earnings. These reserves, however, on the general principle of compound interest, quickly swell the purely investment earnings for the common shareholder, and progressively increase the rates of conservative dividend. The average investment return of  $6\frac{1}{2}\%$  posited in this illustration suggests a trust whose capital, although widely distributed, is employed only in acquiring inherently sound securities, of which a very large percentage may be bonds and preferred stocks, and the turnover profits of  $2\frac{1}{2}\%$  are the very

<sup>4</sup> In the illustration allowance has not been made, of course, for taxes; nor has the cost of marketing the common been taken into consideration.

least which a well-managed investment portfolio should average through the years.

**Illustration Applicable to British Trusts.**—As the above figures more closely approximate conditions in the United States today than the circumstances surrounding the early development of British investment trusts, let us take another hypothetical case which exhibits the average experience of the latter in the last three or four decades. Let us assume that in the eighties or nineties the total capital of a typical Scottish trust is divided in the proportions of one-third ordinary, one-third preferred, and one-third debenture. This ratio was not uncommon, it being the practice to issue debentures to at least one-half of the share capital, and preferred stock from 50% to 60%. The ratio of debentures to total outstanding share capital often reached 100%, while fully 75% was frequently found. The debentures could be sold on a 4% yield basis and would carry a long maturity or be of a perpetual character. The preferred must command a slightly better rate—let us say 4½ to 5%. The total capital, inclusive of that raised by the sale of common stock, could be invested conservatively to yield 5½ to 6%. On two-thirds of its investments, therefore, the trust has, for nothing more than a small administrative cost, a return of at least 5½% for an outlay of 4½%. This represents a net interest of 2% on the equivalent of the common stock. In the meantime, the securities representing common stock investment are also drawing the same rate. About 8% is, therefore, available for common stock at a time when half that rate is considered a fair return for senior securities. This dividend is obtained with no more effort than a careful examination of purchased securities, and with no more risk than is entailed in buying any high-grade foreign and domestic issues. Furthermore, no allowance whatever has been made for profits on turnover, which always are shunted to a contingent fund in the case of the British trusts (see Chapters VII and VIII).

## Borrowing on Bonds and Debentures

The safest, and probably in the long run the most profitable, form of borrowing is by means of issuing bonds, or debentures, with maturities stretching over a period of years. A distinction should first be made between debenture bonds, or "debentures," as they are called in Great Britain, and the mortgage and collateral trust bonds more commonly employed in the United States.

The following definition in Sir Francis Palmer's "Company Law" describes the instrument used by British investment trusts:—

The term debenture stock in common parlance is used to describe a debt owing by the company, payable at a fixed date, or in the event of the winding up, or some other contingency, and in the meantime carrying interest at a specified rate, and secured usually by a trust deed on the property of the company. The debt is generally made payable to trustees, and the beneficial interest thereof is represented by certificates held by the debenture stockholders. (Eleventh Edition, London, 1921, Page 294.)

Strictly speaking, then, a debenture bond is one issued without a legally attested mortgage lien, or the specific pledge of collateral. It is a "floating" charge on income only secondary to that of any outstanding mortgage bonds. The "collateral trust" bond is one issued on the basis of deposited securities, which are held by a trustee for the bondholders to assure payment of interest and principal. Very rarely, if ever, does one find a British trust offering bonds backed by collateral lien on a segregated part of its portfolio, although the debentures are usually secured by trust deed, deed poll, or indenture. However, in at least fifteen British trusts with whose organization the writer is familiar there are no special deeds or indentures of the kind to protect the debenture holders. The right of the management to realize profits or avoid losses by selling and reinvesting—their complete discretion in handling the entire investment



portfolio according to broad principles stated in the memoranda of association—is never questioned. As long as the trust is a “going concern,” it may change its investments without consulting the debenture trustees, provided the interests of the debenture holders are adequately protected.

**Debenture Bond Trustees—Other Standards of Safety.**—These “debenture stock trustees” are nominated by about 50% of the British investment trusts to protect the interests of the bondholders,<sup>5</sup> and in the event of insolvency the “floating” charge enables the receivers for the debenture owners, as for the ordinary American mortgage bondholders, to hold the assets of the trust as against less favored creditors. In addition to the fact that the debenture is usually a floating charge on all the undertaking and property, it is doubly secured in a few instances, and resembles the collateral trust bond. For instance, the Debenture Corporation, Limited, and the South African and General Investment Trust Co., which are in part investment trusts, issue debentures secured by trust deeds, as a fixed charge on deposited securities of a value greater than the debentures by at least 10%; and also by a floating charge on the undertaking and assets. The essential soundness of the debenture, however, necessarily rests upon the integrity and ability of the directors, and the ratio which borrowed bears to shareholders’ capital.

**Limitation of Debenture Borrowing Powers.**—The extent of borrowing on debentures, as compared with the amount of subscribed capital, is determined, for a British trust, rather by its articles of association than the Companies Acts. The latter impose no restrictions, provided the power to borrow is em-

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<sup>5</sup> This seems of more psychological than legal importance in the United Kingdom. It is difficult to see what extra assurance such trusteeship gives the debenture holders, and there is no marked difference in the salability of debenture stock issued with, and without, the special trust deed. “Where there is a trust deed, whether for securing debentures or debenture stock, the trustees can be plaintiffs in an action for enforcing the charge; but, commonly, the action is brought by a holder of the debentures or debenture stock, and the company and its trustees are made defendants.” Palmer (*ibid.*). It is interesting to note that there are differences between the English and Scottish law in connection with the technical nature of the debenture lien—but in practice these differences are unimportant.

bodied in the constitution of the company. This is, of course, always expressly reserved in the memorandum of association.

Debenture stock is ordinarily limited, in the articles of association of British investment trusts, to an amount not exceeding outstanding share capital. If borrowings were heavier, there would be difficulty in obtaining stock exchange listing, and underwriters and investors would look askance at the company. Some companies, as the Foreign American and General Investment Trust, limit their borrowings to one-third of the fully-paid capital, others to 40, 50, 75, and 80%. Fifty per cent is a common limitation. War experience has amply confirmed the wisdom of these restrictions.

The following companies are among those limiting debentures to 50% of their subscribed capital:—the Army and Navy Investment Trust Company, the General and Commercial Investment Trust. The Anglo-American Debenture Corporation has an 80% limitation, and the London and New York Investment Corporation limits its debentures to 75% .

The “Debenture Securities Investment Company” has this interesting section in its Memorandum of Association :

- (1) The Company is not to be at liberty to borrow or raise money by the issue of debentures or debenture stock, constituting a floating charge on the Company's undertaking and property, without the sanction in writing of the holders of 90% of the issued capital of the company, and so that—
- (2) The total amount at any time owing in respect of money borrowed, or raised, shall not, without the like sanction, exceed 30% of the issued capital.

**Ratios of Outstanding Debentures.**—By reference to section II of Appendix B the reader will be able to visualize the relative importance of debenture capital for some eighty investment trusts of Great Britain. This constituted 38% of the entire capital in 1912, and 34% in 1921. Comparatively speaking, debenture stock has been declining in importance during the last two decades, although in the last two years many such

issues have been launched in London and new activity in borrowing seems likely among investment trusts.

**Maturity and Redemption of Debentures.**—The debentures issued by British trusts are both perpetual and terminable. Borrowing by bonds without redemption date is permitted by the Companies Acts, and the strong position enjoyed by many London and Edinburgh companies, despite their moderate earnings on portfolio, may be attributed to the perpetual use of capital obtained at low rates in the nineties, and the first decade of this century. Perpetual debentures have occasionally been issued under a proviso making them redeemable at the option of the company. Terminable debentures, or bonds of fixed maturity, are also commonly employed, but by no means to the extent practiced in the United States, where coupon bonds of definite redemption dates are universal.

Whether the debentures of fixed maturity are payable at a near or distant date depends, of course, upon the advisability at time of issue of obtaining funds for long periods at prevailing market rates. As stated above, the general rise of interest rates over a long period has given many older London and Edinburgh trusts a decided advantage; while the majority of them, adapting their offers to prevailing conditions, have emitted several series of debentures issued at different times, and paying different rates of interest.

Short-dated debentures have been popular in Scotland. Loans with fixed and early maturity protect the lender from depreciation of his capital, and appeal to the cautious investor north of the Tweed. Furthermore, trustees desire to guard their funds until the beneficiary attains his majority, when the capital should be free for such disposition as the latter may wish to make. During recent years the terminable debenture has enabled investment trusts to obtain capital under conditions permitting refunding on more favorable terms. This is not an unmixed advantage, however, as the refunding may have to be

carried out at a time when interest rates are higher, and the lack of permanent capital deprives an investment trust of the stability of net income characteristic of the older and more successful companies. A prominent Glasgow firm has recently intimated that the cost of capital is probably as low now as it will be for many years, and that it is their intention to throw a larger proportion of their debenture stock into a long maturity. There are great differences among Scottish trusts in this respect.

**Rates and Yield on Debentures.**—The rates paid on debentures vary in the United Kingdom from  $3\frac{1}{2}\%$  to  $5\%$ . For obvious reasons the issue of debentures has been less profitable during recent years, but borrowing on a net cost of rather less than  $5\%$  has been lately possible in Scotland, while at currently quoted prices the average yield of debentures for the largest companies of Great Britain would be in the neighborhood of  $5\frac{1}{4}\%$  for the purchaser.

The latter figures attest the great popularity of debentures issued by British investment trusts, some of which, in fact, have been able to borrow on terms comparing favorably with those offered by the Exchequer. A 1923 issue of the United States and General Trust Company, for instance, was completely absorbed on a  $5\%$  basis, a net yield no greater than that of several contemporary British Government issues. Of late therefore (1924 and 1925), there has been a growing amount of debenture borrowing on very favorable terms. The net cost of capital so obtained, as cited above, has frequently been  $5\frac{1}{4}\%$  or less for well-established investment trusts in England and Scotland—a condition reflecting the trustee character of the investment trust bond, of which insurance companies remain large owners in the United Kingdom.

**Debenture Borrowing Less Important than Formerly.**—Nevertheless, it is significant that although the average capital of British investment trusts (see Section II of Appendix A) has grown by at least £100,000 since 1912, there has been less than



proportionate increase in the average debentures. The principal expansion is, as might be expected, in common stock, which carries 70% of the increase. Assuming the amount of the outstanding share capital to be a safe limit for debentures, it appears, therefore, that British investment trusts may now conservatively expand their borrowings a full 100%, or, roughly speaking, by £30,000,000. This amounts to one-third of their total capitalization, and would greatly enhance their investing power. Such an increase in debenture borrowing, even if financial conditions were favorable, would of course, require alteration of many articles of association, and the removal of certain arbitrary limitations dealt with earlier in this chapter. It would be difficult to estimate with accuracy the extent to which such borrowing could be further resorted to under present operating rules, but capital could be considerably expanded by calling up unpaid portions of previous subscriptions, and issuing new stock within the limits of authorized capital.

**Bonds Issued by American Investment Trusts—Collateral Trust Bonds and Substitution in Portfolio.**—It must not be assumed that the British debenture bond is inherently superior for investment trust purposes to the collateral trust bond more familiar in the United States. An understanding for substitution of collateral satisfactory at once to trustee and management can be embodied in the trust agreement under which bonds are issued. Thus there is coupled a reasonable facility in altering the portfolio with the added assurance which a public unacquainted with investment trusts must necessarily feel in obligations secured by deposit of investments.

**Means Employed by the International Securities Trust of America in Borrowing on a Gilt-edged Basis.**—The International Securities Trust of America has sought in four ways to approximate conditions under which it could borrow on a gilt-edged basis. These are as follows:

1. In its agreement with the Trustee for its bonds, the Trust

covenants that the market value of collateral securing the bonds shall always be maintained at a minimum of 115% of the par value of the bonds outstanding. The Trustee only authenticates new issues of the bonds when collateral providing this margin is actually deposited with it in sufficient amount to cover all of the new issue. If the market value of deposited securities falls below 115% of the face value of outstanding bonds, deposit of further securities is required on pain of default.

2. It is stipulated that when \$1,000,000 or more of bonds are outstanding, the underlying collateral shall always be so diversified that not more than one-fourth of 1% is in any one security.

3. Section 2 of Article V in the Amended Declaration of Trust provides that "No obligation shall be issued unless at the time of the issuance thereof the value of the cash and securities (taken at the net cost price thereof) held by the Trustees hereunder shall exceed the aggregate amount of all indebtedness of the Trustees hereunder (except that represented by the principal amount of the Obligations) by an amount equal at least to one hundred eighty per cent (180%) of the aggregate principal amount of such Obligation and all other Obligations at the time issued and outstanding."

4. After payment of interest on the bonds, and before meeting the preferred dividend, the Trust binds itself to set aside annually 15% of remaining net revenue until such time as a special Bond Interest Reserve Fund has been accumulated equivalent to five years' interest on all outstanding bonds. This Fund is to be maintained thereafter.

**Mortgage Bonds and Debentures.**—Although the tendency among American investment trusts is to authorize borrowing by bonds or secured notes, it is yet too early to anticipate the average ratio which borrowed capital will bear to subscribed capital. Nor is it possible at this time to foretell whether the species of collateral trust bond issued by the International Se-

curities Trust of America will become a type in the United States, or will be succeeded by mortgage or debenture bonds involving even greater flexibility in handling the portfolio.

The cost of capital obtained by the issuance of bonds under a collateral trust agreement is increased by the clerical work and delays involved in arranging for substitution of collateral, especially when quick action is advisable in taking gains or avoiding losses on some deposited security. By retaining direct custody of its entire portfolio an investment trust is enabled the better to guard its investments, while the expense of maintaining constant relations with the trustee is avoided. It is significant that the International Securities Trust of America is contemplating a new bond protected by the 180% provision mentioned above, and resembling the British debenture in having no deposited collateral.

**Bank Loans.**—On general principles investment trusts will do well to avoid proportionally heavy bank borrowing. Unlike discount and commercial paper houses, they hold almost exclusively assets which, while readily negotiable, are of distant maturities. The cost of bank credit, even when granted upon diversified, collateralised securities, may vary so erratically, and the credit itself may be withdrawn so arbitrarily, that an investment trust would be compelled to liquidate a portion of its holdings at times when it would not otherwise choose to do so.

Nevertheless a reasonable amount of well-secured bank borrowing may be useful and profitable, especially as rates are generally much less than those payable on bond capital, and the cost of opening the credit is negligible as compared with the outlay involved in marketing securities of the trust. This may afford a means of anticipating capital shortly to be derived from a flotation of bonds or notes, or it may provide capital temporarily, pending a more auspicious investment market. Of especial advantage to an investment trust would be the creation of so broad a market for its short-term paper that considerable sums

could be raised at the lower rates of the commercial paper and bill market, while regularly timed maturities are taken up by the proceeds of new issues. In this way the trust may obtain **what** is equivalent to a substantial amount of permanent new capital, supplementing, on much more favorable terms, the funds raised by issuing long-term obligations.

For all these reasons, the right to borrow on short term is generally reserved by American and British trusts. A common limitation in such borrowing, found among British investment trusts, is thus stated in the prospectus of the Stockholders Investment Trust:

The directors may for temporary purposes borrow sums equal to 10% of such issued capital and reserves for the time being.

Conditions under which short-term borrowing may be effected by different American investment trusts will be found in Chapters XV and XVI.

With British trusts bank loans were perhaps more common before the war than now; and although they occasionally figure in present balance sheets, the tendency in the stricter form of investing company has been to reduce such accommodation to the minimum. An examination of the balance-sheets of several of the more important companies shows no bank loans outstanding. While it is always possible that "window dressing" may reduce such liabilities at stated times, the insignificant interest payments on bank loans recorded in the profit and loss accounts prove that overdrafts and collateral loans are usually small in comparison with capital, temporary in character, and often made merely in anticipation of early maturities. As it only underwrites issues it is prepared to purchase (see Chapter V) it does not act as a promoting company or depend for its revenue upon interest from short-term loans, the British investment trust finds bank borrowing, except upon occasion, an unsatisfactory form of financing.



**Short-term Loans from the Public.**—Of comparatively recent development among a few investment trusts of Great Britain is the raising of money by short-term notes of from six months to a year, bearing interest of  $\frac{3}{4}$  or 1% above the bank rate. Deposits are also accepted, payable on a month's, or even a week's notice, on which interest is allowed ranging  $\frac{1}{2}$ % above the bank rate. A very few well-established investment trusts on the other side have had at times as much as several hundred thousand pounds of liquid capital obtained in this way, which has been profitably employed in the short-term market. This was particularly the case when British Treasury bills, some years ago, were selling on a more than 6% yield. At present profitable operations in the market are made possible by the abundance of short-term Treasury bonds, and other sound securities of short maturities actively dealt in on the open market. Such transactions, while legitimate and profitable, are ancillary to the main lines of investment trust activity, and could be undertaken in certain American commonwealths only by institutions operating under the banking laws.

## CHAPTER IV

### THE RAISING OF INVESTMENT TRUST CAPITAL

**Investment Trusts a Recent Development in the United States.**—The reader may by this time be asking why investment trusts have not in previous decades become familiar and popular media of investment in the United States. The fact that they are, in our country, essentially a post-war development may be attributed to reasons partly psychological, partly financial and economic; but none of the circumstances hitherto retarding the organization of such companies weigh against the validity of their development provided the beginnings are firmly rooted in conservative and tested principles. The activity in creating trusts during recent years and the increasingly encouraging response of the American people bear witness to this. But what are some of the factors which account for the comparative paucity of investment trusts, even today, in the United States?

**Yield of Foreign and Domestic Investments.**—It is often stated that the British investment trusts enjoyed in their earlier years opportunities of a kind never available for their American prototypes. Among these advantages was the great spread between borrowing rates in the home market and the yield to be obtained from American, and other foreign, investments. International arbitraging, as it is carried on today, was in its embryo forty years ago, and when many of the powerful trusts of London and Edinburgh were still young, it required but little skill to command 7% and 8% yields in a diversified portfolio of foreign senior securities purchased in part with money borrowed at a net cost of 4% or under.

The United States being before the late war rather a bor-

rowing than a lending country, the capital of her people found for the most part adequate and remunerative employment in domestic business. The bold contrasts between foreign and home yields were not ever-present to stimulate the accumulation of capital for co-operative oversea investment, and if the return to capital was unusually liberal within the country, so also was the cost of borrowing there somewhat higher in proportion.

Differences in yield between foreign and domestic investments are not, however, the *raison d'être* of investment trusts. It would be a mistake to assume that the capital of investment trusts must be largely, or even preponderatingly, invested in foreign securities. Adequate margins exist, and have long existed, between borrowing rates, and the probable return from skillful purchase and turnover of primarily domestic securities. The power to enjoy the higher average yield of semi-speculative holdings without taking the individual purchaser's risk of loss of capital could as well have been utilized through common share investment trusts fifty years ago as now, if principles of organization and management had been equally well understood. Substantial margins now exist between credit rates abroad and both the yield on American securities, other things being equal, and the cost of investment trust capital in the United States. Nevertheless, international differences in return on capital have not the importance in investment trust development at this time that they commanded in the eighties and nineties.

**Psychological Factors.**—Perhaps more fundamental reasons for the comparative lack of investment trusts in America to this time are to be sought in certain psychological factors. It has long been the practice in America to make appeals to the public through regular intermediaries of the speculative securities market, for the purpose of financing undertakings of more future promise than present substance. To a far greater extent, in the nations of the European Continent, the public has been held in a kind of financial tutelage, their contributions to the

promotion of new or speculative business enterprises being effected to a considerable extent by way of great commercial banks, which were also what is known in France and Belgium as "Banques d'Affaires." Although gullible Americans have suffered losses running into staggering totals by purchasing worthless paper, sometimes from voluble but dishonest agents, but more frequently from over-optimistic and ignorant salesmen, it is nevertheless true that there is in the United States a more general diffusion of industrial and commercial profits than in any other country.

The American saver of very limited means has been accustomed to bombardment from every side, in the mails and through personal canvass, by glowing prospectuses offering him participation in every conceivable kind of business El Dorado. It is perhaps only natural that a small percentage of large returns from this "hit or miss" purchasing into various enterprises should attract more attention than a high percentage of losses or of low returns characteristic of the now passing heyday of speculative stock salesmen; and for this reason we are prone to under-estimate the social costs underlying some of our great industries which were necessarily quite speculative in their early days. The expanding scope of the state "Blue Sky" laws, and the more stringent enforcement of Federal Postal laws are gradually limiting the "happy hunting ground" of irresponsible promoters, but the investor of small capital in America is still illustrative of the fact that "Hope springs eternal in the human breast," and he wishes to earn on his mite a rate of return comparable with that which he has been led to think is the habitual expectation of the more fortunate.

The fact that the rugged independence of American character, coupled with the wholesome tendency to appeal directly to the ultimate saver, has accustomed investors in the United States to look eye-to-eye with specific business propositions (whether or not they understood them) presents perhaps a difficulty for the American investment trust movement in its



earlier days. At best, the organization of an investment trust is not easily visualized by the average investor, whose real interest it is primarily designed to serve. It is difficult to "dress up" an investment trust in lurid colors carrying popular appeal, and at the same time to be honestly consistent with the conservative, "safety first" methods which should characterize this type of company. The lure of possibly greater profits in less secure channels of investment is unfortunately often greater than the attraction of almost certain security, and the substantial but less exalted earnings promised to investment trust shareholders.

**Educational Work of Pioneers.**—Despite these factors hitherto retarding the growth of investment trusts in the United States, there is good reason for thinking that the public will generally respond when a sufficient number of sound undertakings have been developed to offer variety in investment trust securities, and to educate the investor in the A B C of investment trust organization. Not even the natural organizers are as yet fully acquainted with the liberal profits which may reasonably be expected by adapting foreign experience to American conditions; and until there exists a considerable body of bankers and brokers who recognize the advantage of creating investment trusts in America, and are thoroughly informed as to the best methods of doing so, it can hardly be expected that the public will respond with alacrity to new issues of the kind. When the spade-work has been done, it is the belief of the writer that further sources of capital will thus be tapped, and that the roots of commerce and industry will be enriched both at home and abroad by new rivulets of savings accumulated thereby.

**Simplicity in Selling Prospectuses.**—As a general rule, it is most important to remember that the selling proposition for both bonds and shares of investment trusts should be made as simple and as easily understood as possible, for undue complexity in organization and in distributing methods not only

confuses salesmen who may also be carrying competing offerings, but seriously militates against the placing of such issues in the market. In fact, partly with the idea of simplifying the plan and more readily communicating the basic ideas to the public, a number of firms have recently introduced into the American market a modification of the investment trust structure which, while following some of its forms and offering certain of its advantages, has introduced a radical departure in generally accepted investment trust principles and may lead to unfortunate consequences if not developed with the greatest caution and subjected to keen scrutiny on the part of all concerned. Reference is had to the stock conversion companies, treated in Chapter XIV.

**The Appeal of Investment Trust Securities.**—In introducing investment trust securities to the American public one does well to remember that emphasis should be laid upon the salient features of each type of issue offered, even though concentration upon the immediate selling argument prevents other than a very cursory description of the general set-up and functioning of the trust. Bonds will carry a different appeal than preferred stock, and preferred stock than common. The average investor must first understand clearly the offering he acquires and develop his detailed knowledge of the business as a whole in studying the rights and limitations of the securities he holds.

**I. BONDS.**—There is no doubt that the potential market for obligations of this character has been vastly expanded by the bond-buying habits developed in the American people during and immediately after the war in connection with the financial needs of the Treasury. There are probably today hundreds of thousands of people with one or more Liberty Bonds who before 1914 had never cut a coupon.

The appeal of investment trust bonds is, above all, their exceptional safety. In Great Britain they are widely purchased

by institutions seeking "gilt-edged" investments. As mentioned in the preceding chapter British insurance companies are large buyers of investment trust debentures and preferred stocks. Their securities are also popular as trustee investments. In the United States some time will doubtless elapse before state laws assimilate investment trust bonds to the class of trustee securities, and for this reason it is likely that, when due consideration is given to safety of principal and assurance of steady income, these obligations will give for a time a more favorable yield to the investor than any other comparable security. As the public becomes accustomed to bonds of this character, the cost of marketing them will decrease and their yield to the new purchaser, other things being equal, will decline. These circumstances, as well as the above-mentioned factor, are likely to cause a considerable rise in market value of investment trust bonds, unless, indeed, a general advance in interest rates causes marked depreciation in all fixed-income securities.

As in the case of other bonds which are based upon substantial values, any investment trust bond issued by a well-managed company will show a large margin of equity contributed by shareholders' capital and accumulated by undistributed earnings. Investment trust obligations of the collateral trust species offer the further protection of diversified deposited securities. The peculiar elements of safety in a properly authenticated investment trust bond may be summarized as follows:

(a) *Ready Marketability of the Issuer's Assets.*—The major part of an investment trust's portfolio (and this is practically the whole of its assets) generally consists of listed, and easily marketed securities. If receivers for the bondholders were compelled to liquidate, the realized value would, in numerous instances, actually exceed the book figure for investment portfolio; in any case an appreciable shrinkage from current valuations, when the assets are "put under the hammer," is extremely unlikely.

(b) *Diversification in the Issuer's Assets.*—The force of this statement will be at once appreciated when it is recalled that the portfolio of an investment trust is systematically diversified. The immediate sale of its entire holdings, affecting but slightly the total current offering of each one of the many investments represented therein, should not appreciably impinge upon the general course of the securities markets. The ordinary mortgage bond, representing prior lien upon the physical property of a "going business," or upon improved real estate, is only as secure as the income-yielding power of these underlying assets. Such bonds, as well as the typical collateral trust bond resting upon hypothecated obligations of a single issuer, are inherently sound only if a specified business, or establishment, is economically productive; and they command only such cash value, in event of default in interest payments, and winding up of the business or foreclosure of the mortgage, as the disposal of a single property or business can produce from the more or less arbitrary market capitalization of anticipated earnings at a time of forced liquidation. While good real estate mortgage bonds are as secure an investment as any one could reasonably desire, there is lack of uniformity from state to state in laws relating to real estate valuation for mortgage assessment purposes. The overvaluation of land and improvements and the frequent inadequacy of the owner's real equity, are matters of common observation with any student of realty problems.

(c) *Unlikelihood of Default.*—There is the further circumstance that investment trust bonds should be less liable to default of interest than any other species of obligation, except, perhaps, the debts of financially strong governments. The portfolio of a typical investment trust, consisting primarily of prior yield securities, and representing a broad scattering of holdings, is constantly yielding dependable income, regardless of current market fluctuations. New capital, raised in any way,

being promptly invested, produces revenue without the delays and unforeseen difficulties encountered in many undertakings.

2. **PREFERRED STOCK.**—The investment trust bond, however, like non-participating preferred stock, is a fixed yield investment, and as such, subject to any of the drawbacks attaching to such securities. For this reason it is well to bear in mind the following advantages attaching to preferred stock issued by many investment trusts:

(a) *Higher Yield than Warranted by Intrinsic Risk.*—The position of the preferred stockholder, if protected by an adequate margin of reserve or of common stockholders' capital is as safe as that of the bondholder in most enterprises, and for the reasons sketched above. Nevertheless, as it ranks after the bond or debenture, the preferred carries a yield of  $\frac{1}{2}$  to 1% above it, and makes an attractive combination of return and safety for those concerned primarily with the latter.

(b) *Units of Preferred and Common.*—Apart from the fact that preferred stock may offer participating features, the practice is general among investment trusts, as described in the last chapter, to issue units of preferred and common stock, thus enabling an investor to enjoy a combination of the anticipated increasing earning power of the latter, and the prior claim in income and principal of the former.

3. **COMMON STOCK.**—The sources of earnings on the common stock of investment trusts, and the factors causing appreciation in their value, have been touched upon in preceding chapters, and need only be mentioned here. They are (a) the yield on investments, (b) profits on realization, which are generally appropriated to reserves and thus ultimately create further equity for the common shareholder, (c) the margin between (a) and (b), and the cost of borrowed capital for such part of the portfolio as is acquired with borrowed funds, and (d) any other earnings, such as the underwriting profits and fees ordinarily enjoyed by British trusts. If the management of



the trust is reliable and intelligent, the common shareholder should therefore enjoy profits in the business sense, in addition to the average net investment return which a mixed portfolio can safely yield. Moreover, such business profits should accrue to the common shareholder, whether the trust purchases primarily fixed-income securities or common stocks, as gains on turnover can be taken quite as readily in one class of security as in another, and as the advantages of borrowing obtain in either case.

**Investment for the Well-to-do.**—It is commonly assumed that the investment trust share is *par excellence* a poor man's purchase, and that the well-to-do are able to diversify their own holdings, borrow advantageously, and "play the market" profitably. Assuming this to be the case—and it is not often so—there are at least two advantages which rich, as well as poor, enjoy in acquiring common stock in a sound investment trust, and which are telling "selling points" among investors of the former type.

**I. AVOIDING INHERITANCE TAX COMPLICATIONS.**—An individual consistently maintaining a diversified portfolio must some time anticipate the complications of our State and Federal inheritance taxes,—which do not arise to the same extent when the diversified portfolio is held by an investment trust, and the individual's participation therein takes the form of common stock, or of participating certificates.

No less than thirty-seven states impose an inheritance tax on shares of corporations organized in those states and owned by the estate of a non-resident decedent. It would, therefore, be entirely possible for one's estate to pay inheritance taxes in over thirty states in addition to the tax of the state of residence and the Federal estate tax. The method of collecting the tax is simple. The state forbids the corporation, under pain of severe penalties, to transfer stock owned by a decedent until the tax has been paid, and because the state has undoubted

jurisdiction over the corporation, it can with little expense and trouble collect the tax. An extreme case would be a man owning stock in thirty-five corporations, each of which was organized in a different one of the states which imposes an inheritance tax on stock of a domestic corporation owned by a non-resident decedent. Assuming that the value of each of the stocks was in excess of the statutory exemptions, the decedent's executors would be required to pay a tax to thirty-five states in which the decedent was not a resident, in addition to the tax payable to the state of his residence and to the Federal government. This would be an unusual, but none the less possible, case.

In the supposititious case given above, stocks of corporations organized in the taxing state have been used merely as an example. In some states, stocks and bonds of corporations which merely do business or own property in the state are taxed even if owned by a non-resident decedent. In a few states, the right is also asserted to tax municipal bonds owned by a non-resident decedent. Let us assume, however, that the same thirty-five stocks are held by an investment trust, the individual taxpayer merely having a certificate of beneficial interest or a share in the trust. Under such circumstances, it may well be doubted whether the states in which the thirty-five corporations are organized or do business, and in which neither the individual nor the trust is domiciled, could possibly tax the investment trust portion of the decedent's estate. In any event, the circumstances which render it easy for the state taxing authorities to collect this tax from non-resident estates would not exist. The stock would be registered not in the name of the decedent, but of the trust. Upon his death, there would be no occasion for transferring the stocks on the books of the corporations. The decedent's executors would merely have transferred on the books of the trust the certificate of beneficial interest, or the shares.

2. ASSURING CHECK-UP OF INVESTMENTS.—The more widely an investment portfolio is diversified, the greater becomes the difficulty of supervising it. This circumstance alone makes more than very limited diversification impracticable for the individual unless the services of a proficient trust company are utilized, or unless, in addition to peculiar skill in these matters, the investor enjoys ample leisure to study the many phases of his problem. Joint management effected through investment trusts gives assurance of provision for such humdrum and easily overlooked matters as conversions, drawings, subscription privileges, coupon clippings, and so on. For instance, it will be recalled that the holders of nearly \$1,200,000 American Telephone and Telegraph Company 6% Convertible bonds, by neglecting to exercise conversion rights which lapsed August 1, 1925, lost \$340 for each \$1000 bond.

**Marketing Problems—METHOD OF DISTRIBUTION.**—Each type of investment trust security, therefore, carries its peculiar appeal, and for this and other reasons the system of distribution through reputable local dealers and bond houses commends itself. Knowing the needs and enjoying the confidence of their clients, such investment bankers are especially qualified to introduce a new species of security into their several communities. This is not only a more rapid, and in the long run probably cheaper, method of raising capital, but it is almost essential in marketing offerings which call for such a measure of confidence in the business and its managers. Direct retailing, over the heads of local dealers, however effective it may be with speculative and promotive issues, is not satisfactory with securities of less lurid appeal; nor is it conducive to the creation of a steady dependable market for continued and expanding offerings of the kind characterizing investment trust finance. As popular knowledge is particularly circumscribed in this field, considerable educational advertising in financial journals and high-grade newspapers is required.

LISTING AND QUOTATIONS.—Investment trust securities in Great Britain are generally listed and commonly dealt in on the exchanges. In the United States, a close market is usually maintained, and no investment trust issue is quoted on the New York Stock Exchange. The reader will find daily in the *New York Times* and other papers of New York and Boston, under the caption "Investment Trusts," the "bid" and "asked" quotations for offerings of a few American investment trusts, and "stock conversion" companies.

As marketing is likely to be extensive rather than intensive at first, and among people less interested in speculative and trading profits than in the investment features of their purchases, a considerable period may elapse before the listing of investment trust stocks and bonds would result in anything more than a nominal quotation. A limited market easily lends itself to manipulation. It is a well-known fact that a majority of bonds listed on the exchanges are not actively traded in; that quotations are not always available on listed securities; that their principal market is very frequently among bond houses which repurchase securities originating with them, and other buyers and sellers operating independently of the exchanges; and that the marketability of any security, whether listed or unlisted, depends fundamentally upon the extent of its distribution, and the activity and good faith of the brokers and issuing houses which handle it. One advantage of listing is the fact that collateral loans can generally be effected more readily, and with a smaller margin, in the case of listed securities.

The maintenance of "bid" and "asked" figures in an unlisted security, dealt in mainly by those desiring a bona fide transfer of investment values, has created an adequate market for large numbers of issues, and permitted such an extension of direct trading between interested houses on behalf of their clients as to relieve the issuer of the necessity of rebuying more than a fraction of the offerings in any series of transactions. How-

ever, the listing of investment trust securities is probably only a matter of time, when increase in the number of such issues and the greater distribution of the same will render this step advisable.

**"TAP" SALES, AND OCCASIONAL FLOTATIONS.**—Whether the investment trust should raise its funds by keeping "on tap" its offerings to the public and "feeding" them out in response to demand, or secure lump sum increments to its capital by flotations at stated times, depends upon a number of factors. In Great Britain the latter method is generally used; in the United States the former method prevails.

Newly organized investment trusts will find it advantageous to bring in their capital by degrees, until the problem of investing it is being effectively solved. A large volume of inactive or ineffectively invested capital, part of it bearing fixed charges, is more a liability than an asset. Furthermore, "tap issues" are better fitted for a market in which the investor is learning for the first time the advantages of participation in investment trusts. On the other hand, trusts whose buying activities are well organized, and whose financial standing is such that assurance of a successful appeal can be obtained without costly underwriting, will probably find occasional flotations more convenient and satisfactory than constant marketing. This applies especially when opportunities arise requiring the disposition of large sums within limited periods. Moreover, a tonic effect is likely to be produced upon the market when new offers are made only intermittently.

**Cost of Raising Capital for Long Established Trusts.**—During 1924 and 1925 there had been considerable activity in Great Britain in the launching of new investment trusts, and the expansion of capital among the old. Many of the new companies, being sponsored and directed by people well known in the investment trust world, and belonging to a group of trusts long favorably regarded by the public



because of their stability and earning power, raise even their initial capital with as little difficulty as the older undertakings.

As for the latter especially, the cost of obtaining new capital contrasts strikingly with marketing charges in America. As a rule, additional capital is either privately subscribed, or, an issue being publicly offered, a substantial proportion thereof (often 60%) is placed firm at par in advance through existing shareholders, directors, and their brokers, the latter frequently receiving a lump sum as compensation for their services. For the major part new issues are not underwritten, as the London and Edinburgh markets are more than ready to absorb new offerings of their investment trusts, and as existing shareholders are generally given prior subscription rights. Where underwriting contracts are negotiated the fee does not as a rule exceed  $1\frac{1}{2}\%$ , with sometimes an "overriding commission"<sup>1</sup> of  $\frac{1}{2}\%$ , on the par value of the shares. The practice commonly obtains of offering brokers a commission of  $\frac{1}{4}\%$ , or a stated amount varying from threepence to a shilling per share, dependent upon the nominal amount thereof, on applications bearing their stamp. Brokers are occasionally allowed  $\frac{1}{2}\%$  or  $1\%$  for handling a block of debentures, of which they surrender a part to agencies co-operating in marketing. In general, it seems safe to place the issuing cost for different types of British investment trust capital well within 3% on the par value of securities marketed, bearing in mind the much lower cost, especially in Scotland, to well-established companies.

In addition to these basic marketing costs for issues of British trusts, the government charges must be figured. Thus the letter known as the "allotment letter," sent to each shareholder with his allotment of new shares, carries a stamp duty of sixpence. If the new issue necessitates an increase in au-

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<sup>1</sup> That is, in English financial terminology, the "overriding" commission is the amount which the underwriting syndicate making the original contract is able to pocket when it places any part of the underwriting with other firms, these latter enjoying the regular underwriting commission while the former, for that part of the underwriting it retains, enjoys both commissions.

thorized capital, a tax of 1% must be paid on such increase, regardless of the time of issue. There is also a small *ad valorem* stamp duty, which refers to documents which must be returned to Edinburgh, in Scotland, or to Somerset House, in London, but which amounts to a few pounds only. The fact might be emphasized, in conclusion, that British investment trust issues, which always have a par value, are, in the case of shares, never issued at less than this par value; and are often sold at a premium sufficient to cover the entire issue and marketing cost.

### PROSPECTUSES OF NEW ISSUES QUOTED

There are reproduced below, in part, two recent prospectuses of issues offered by old British investment trusts, which give practical illustration to the foregoing. The first is a leader among the Scottish trusts, and its recent debenture issue, here described, was sold without underwriting and privately placed:

March 7, 1925

This Statement is advertised to comply with the Regulations of the Committee of the London Stock Exchange and is for information only and is not an invitation offering Stock for subscription or purchase. The Directors of the Company, collectively and individually, are responsible for the information contained in this Statement

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#### THE ALLIANCE TRUST COMPANY, LIMITED

Incorporated under the Companies Acts

The Company was incorporated on the 21st day of April, 1888, for the purposes mentioned in the Memorandum of Association.

Authorized Capital .....£2,000,000

Issued:

Fully Paid 4¼% Cumulative Preference Stock..	£ 700,000
Fully Paid 4% Cumulative Preference Stock....	650,000*
Fully Paid Ordinary Stock.....	650,000*
	<u>£2,000,000</u>

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\* £50,000 of this 4% Preference Stock and £50,000 of this Ordinary Stock has recently been issued and is in the course of being paid up in full.

## DEBENTURES:

Terminable and Interim Loans .....£2,884,120

The normal period for which Debentures  
are placed is five years.

Issue of  
£500,000 Four-And-A-Half  
Per Cent Debenture Stock,

of which £400,360 has been sold by the Company at the price of 89½ per cent, less one-half per cent brokerage, the remaining portion being retained until a later date, made in pursuance of Resolution of the Board, under the powers of the Company's Articles of Association, ranking *pari passu* with all existing Debentures and any Debentures or other Debenture Stock hereafter issued and to be repaid on 15th May, 1965, at par. The Stock will be secured by a Personal Bond granted by the Company for the amount of the Stock and Interest in favour of the Trustees, Royal Bank of Scotland, under Deed of Agreement and Trust. The Interest will be payable half-yearly on 15th May and 11th November, the first payment for two-and-a-half months' Interest being made on 15th May, 1925.

Application will be made to the Committee of the London Stock Exchange for permission to deal in the £400,360 4½ per cent Debenture Stock.

The next prospectus offers preferred stock to the public, describes the underwriting arrangement relating thereto, and explains the terms of an antecedent increase in common:

March 30, 1925

A Copy of this Prospectus has been filed with the Registrar of Joint Stock Companies.

Application will be made in due course to the Committee of the London Stock Exchange for a quotation and for permission to deal in these Shares after allotment.

The Subscription List will close on or before the 4th day of April, 1925.

THE UNITED STATES DEBENTURE CORPORATION, LTD.  
(Incorporated under the Companies Acts, 1862-1886)

Authorized Share Capital .....£2,698,000

## CAPITAL

5½ per cent Cumulative Preference Stock issued..	£350,000	
5½ per cent Cumulative Preference Shares now offered.....	£700,000	
		£1,050,000
Ordinary Shares of £1 each issued.....	£300,000	
Guaranteed and in course of being Subscribed..	£225,000	
		£525,000

The balance of unissued Share Capital can be issued either as 5½ per cent Cumulative Preference Shares ranking *pari passu* with the existing Preference Stock or as Ordinary Shares provided that the aggregate amount of all Preference Shares and Stock issued or agreed to be issued shall never exceed twice the aggregate amount of the Ordinary Shares and Stock issued or agreed to be issued.

## LOAN CAPITAL

£1,207,500 4 per cent, Irredeemable Debenture Stock

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Issue of 700,000 5½ per cent Cumulative Preference Shares  
of £1 each at par.

Payable as follows:

On Application.....	1/- per Share
On Allotment.....	4/- per Share
On 1st June, 1925.....	5/- per Share
On 24th July, 1925.....	10/- per Share

The Preference Shares entitle the holders to a fixed cumulative preferential dividend at the rate of 5½ per cent per annum on the amounts paid up thereon in priority to the Ordinary Shares, and are preferential as to capital.

## PROSPECTUS

The Corporation was formed in the year 1889 and carries on the business of an Investment Trust Company.

The Capital has recently been reorganized by writing off the sum of £3 per share uncalled on the 300,000 Ordinary Shares of £4 each then issued, thus reducing these shares to shares of £1 each fully paid up. This reduction of capital has been sanctioned by the Court, and an additional 225,000 Ordinary Shares of £1 each have

recently been offered at £1 15s. 6d. per share for subscription, and the subscription of such shares has been guaranteed as below mentioned.

By a contract dated 18th March, 1925, and made between the Corporation and Messrs. W. Greenwell and Co., the latter undertook to guarantee the subscription at the price of £1 15s. 6d. each of 210,000 Ordinary Shares of £1 each recently issued in consideration of the placing by the Corporation with Messrs. W. Greenwell and Co. or their nominees at the above price of a further 5,000 Ordinary Shares, and a brokerage of 6d. per Share on any Shares which they were called upon to take up. In addition, Messrs. W. Greenwell and Co. undertook to place on behalf of the Corporation a further 10,000 Ordinary Shares. The said contract further provided that Messrs. W. Greenwell and Co. would underwrite the present issue for an underwriting commission of  $1\frac{1}{2}$  per cent and an overriding commission of a half per cent on the par value of the Shares.

Copies of the above-mentioned contracts, and a print of the Memorandum and Articles of Association of the Corporation and of the Trust Deeds securing the Debenture Stock, and a print of the last Directors' Report and Balance Sheet may be inspected by intending subscribers at the office of the Solicitors of the Corporation during usual business hours while the list remains open.

A brokerage of  $1\frac{1}{2}$ d. per share will be paid on allotments made in respect of applications bearing the stamp of a broker, banker, or other approved agent.

The definitive Stock certificates will not be issued until after the 1st August next, but in the meanwhile a combined allotment letter and partly paid interim certificate will be issued.

Application for shares should be made on the accompanying form and sent to the Corporation's Bankers with a remittance for the amount payable on application. If no allotment is made the application money will be returned in full. Where the number of shares allotted is less than the number applied for application moneys will be applied towards the amount payable on allotment.

Prospectuses and Forms of Application may be obtained from the Corporation's Bankers and Brokers.

**Cost of Obtaining Capital for New Investment Trusts.—**Most of the new investment trusts in the United Kingdom are, as stated above, affiliated with familiar groups, and for this



reason their capital is obtained on terms similar to those described in the preceding paragraphs. "Founders shares," so commonly issued on the Continent, are as a rule not employed in promoting British investment trusts. Their common stock is practically always sold for cash only, and often at an initial premium above par value which extinguishes at the outset the organization expenses. A few illustrations of companies recently organized in Great Britain will prove illuminating.

The Second Guardian Trust announced an authorized capital of £500,000 in its prospectus of July, 1924. This sum was made up of 500,000 shares of £1 each, offered at £1 1s. As a means of popularizing the issue among people of limited means, arrangements were announced for installment payment extending over a half year period, while optional prepayment in full on allotment was provided at a discount of 3% per annum. When fully paid, the shares were to be converted into ordinary stock, the minimum subscription on which allotment might be made being fixed at seven shares. Application has been made to the Stock Exchange for official quotation and leave to deal. The prospectus announced that "the borrowing powers of the Directors are limited (save with the sanction of a General Meeting) to an amount not exceeding the Share Capital of the Company at the time subscribed."

It is instructive to note that the good record of the first Guardian Trust, with which the new company will be intimately associated, has insured adequate initial capital by this sale of common shares, much of which unquestionably went to holders of stock in the older trust, without recourse to the debenture borrowing power until the undertaking will have justified full public confidence.

The total premium above par at which these common shares of the Second Guardian Trust were sold amounts to £25,000. Preliminary expense of organization, the greater part of which represents stamp duty, was estimated at £8,000, exclusive of brokerage and underwriting fees. As for the latter, it was

announced that the entire issue, of which more than 50% was already spoken for at the time of the public offering, had been guaranteed at a commission of 1% ; as for the former, the company agreed to pay a brokerage of  $\frac{1}{4}\%$  "on the amounts allotted in respect of applications bearing the stamp of a banker, stockbroker, or other approved agent." Thus it is seen that the entire outlays in launching the Second Guardian Trust and securing its capital were less than two thirds of the premium at which the common shares were sold, and the Trust commenced its operations with a paid surplus.

The Second Mercantile Trust, launched in March, 1923, shows many similar features. The authorized share capital is £1,000,000, divided into shares of £1 par value and offered to the public at a premium of one shilling (21s. per share). When fully paid the shares were convertible into equal amounts of preferred and common stock, the former being entitled to a 5% cumulative dividend without further participation, and both ranking for dividend from date of allotment. It was stated that steps would be taken to secure permission to deal on the stock exchange and to enjoy an "official quotation."

The close association of this new undertaking with the successful Mercantile Investment and General Trust Company has also enabled it at the outset to extinguish organization, brokerage, and underwriting expenses by means of the premium on its shares. The underwriting commission in this case amounted to a total of 2%.

Somewhat different methods were followed in the organization of the Scottish National Trust (July, 1924). The capital of £500,000 consists of 50,000 shares of £10 par value which is split into 5% cumulative preference, and ordinary stock, in the proportion of 60% of the former and 40% of the latter. The fact that the directors were already "aware of applications for 30,000 shares" at the time of the public offering suggests that the stock will be closely held, a circumstance which also perhaps accounts for the refusal to enter into any underwriting agree-

ment, or to assume any promotion expenses. The issue was promptly and heavily over-subscribed.

The prospectus of the "Stockholders Investment Trust, Limited" (June, 1925), in which the entire authorized capital of £600,000 was offered in 60,000 shares of £10 each at par announced that:

The preliminary expenses incidental to the formation and flotation of the Company, including legal expenses, registration fees, printing, and advertising, but exclusive of brokerage, and the expense of stamping and issuing allotment letters, are estimated to amount to about £8,500, of which £6,050 represents capital duty and registration fees, and will be paid by the Company.

The Articles provide that without the sanction of an Extraordinary Resolution passed at a separate meeting of the Preference Share or Stockholders the total amount of 5 per cent Preference Shares and stock issued must not exceed 60 per cent of the aggregate nominal amount of the Preference and Ordinary Stock and Shares issued or agreed to be issued.

No portion of this issue has been or will be underwritten, and no promotion money has been or will be paid.

A fee of 600 guineas will be paid to the Company's Brokers, Messrs. Govett, Sons and Co., of which firm Mr. J. R. Govett is a partner. The Company will pay a brokerage of 1s. per share on all shares allotted in respect of applications bearing the stamp of a Bank, Stockbroker, or other approved Agent.

As yet the American investment trust has not gained that peculiar position in the world of finance which the British investment trust has long enjoyed. This, and the further fact that flotation costs are higher in New York than in London, account for the heavier outlays which American trusts, marketing their securities in ways familiar to the United States, have been required to pay for their capital. Generalizations cannot be safely made at this point in the evolution of American investment trusts, and the reader who wishes to examine more carefully the problem and methods of raising capital for investment trusts in our country will be well advised at this time to peruse Chapters XV and XVI, for some detailed descriptions.

## CHAPTER V

### MANAGEMENT OF THE PORTFOLIO

**Importance of Sound Buying.**—It is sometimes said in financial parlance that “well invested is better than well earned.” For the investment trust this dictum might be construed as “well invested is better than brilliantly financed.” Although in launching an investment trust in this country the immediate and ostensibly most formidable difficulty is the raising of capital, the success or failure of the trust, and the responsiveness of the public after the initial selling efforts, must obviously depend upon the caution and skill with which the investments are handled. This is the very heart and soul of investment trust management, and he would be a rash person indeed who would venture into the field without careful study of the technique of buying from the viewpoint of investment trust needs, and without associates who from the first will devote themselves to this work in anticipation of constantly increasing capital.

**Qualities Required.**—Any moderately well-to-do investor who manages his own estate and manages it well, knows the exacting nature of his task. He is a captain on the bridge of the good ship “Capital,” alert to gauge each shifting of the financial winds, as well as to guard the efficiency and discipline of his own craft. How much more difficult are the problems of investment trust management appears from the fact that a watchful eye must be kept over portfolios including frequently from two to three hundred or more distinct investments, and that the responsible parties must not fail at any time to take full cognizance of any factors which will influence either the market value or the return on those securities which they hold in trust for the public. Although it would be inaccurate to say that

these administrative problems are unique for the type of company we are considering, they nevertheless present a different picture from those of the commercial banker, the broker, or even the investment banker. The peculiar skill required in investment trust administration is based upon a wide experience in the financial world, an intimate knowledge of economic conditions in many countries, and a vision tinged with the judgment which only years can bring.

**Criteria of Investment.**—Three broad criteria must be kept in mind in investment trust buying, and they may be stated as follows:

1. The securities purchased must conform to the norms of diversification which the trust has set for itself.
2. The securities should meet the trust's standards of intrinsic soundness.
3. They should, if possible, be obtained at figures giving good current yield and promise of capital appreciation, the range of maximum prices set for various eligible securities being based upon an expectation of ultimate profitable turnover.

The first of these criteria assures the stockholder in an investment trust that safety of his capital will be sought in the spreading of risk; the second promises him a constant investment return regardless of the "ups and downs" of business; the last attempts to secure for him, in addition, the business profits which ordinarily result from sagacious purchase and resale. In other words, the result of applying these criteria will be to approximate for the stockholder the same advantages enjoyed by an opulent well-informed investor of international contacts, who at any given time, or in different phases of the credit cycle, is realizing on some of his holdings at a profit, buying other temporarily depressed securities at less than their actual value, and drawing interest and dividends as well on the currently inactive part of his portfolio regardless of the passing valuations which the market may place upon them. This chapter will be



devoted to discussing the application of principles set forth in (1) and (2), while the following chapter will analyze (3), or turnover problems.

**Standards of Diversification.**—The spreading of risk which characterizes investment trusts is essentially among securities of long maturity or without redemption date. The greater part of their capital being derived from sale of stock and bonds, their liabilities are not current or unfunded to an extent approaching the commercial bank. For this reason their deposits with banks, or loans on call, tend to disappear in the measure that acceptable investment opportunities await them, and their purchases of short-term paper are related to the amount of their temporarily borrowed funds.

The limits within which principles of distribution of risk apply is an interesting study which would furnish examples ranging from the broadest diversification to a spreading of risk merely within the specific investment field to which the portfolio is limited. In some instances interests are concentrated in a single country or geographical area; other investment trusts specialize in a given industry, or in several related industries (see Chapter XVI; also Appendix A, Section III), while there are a few examples of investment trusts organized primarily to acquire and handle common shares, or fixed yield securities, as the case may be. Of the latter type are the Bond Investment Trust, which, as its name implies, purchases only bonds, notes, mortgages or other obligations; the Investment Managers Company, whose certificates represent mainly participating interests in common shares; and the Bankstocks Corporation from whose prospectus we learn that:

Without the consent in writing, or at a meeting duly held, of the holders of at least three-fourths of the outstanding capital stock of the company:

No funds of the company shall be invested except in shares of the capital stock of the banks and trust companies above named (together with, in certain instances, capital stock of affiliated securi-

ties companies managed by or in conjunction with such banks and trust companies).

No more than 10 per cent of the total assets of the company may at any time be represented by an investment in the shares of stock of any one bank or trust company and its affiliated securities company, if any, at current market prices.

It is, however, with the typical, rather than the unusual, investment trust, that we are dealing in this chapter, and the following paragraphs will describe the diversification conditions limiting investment among trusts including all kinds of securities in their portfolios.

Among British investment trusts the distribution of holdings is generally so broad that even in the largest companies average investment in any one security amounts at the most to a few thousand pounds. It is the practice with many not to participate to the extent of more than £7,000 or £8,000 in any issue, excepting government bonds during the war and after. The limitations imposed by the articles of association are in terms of percentages, however, rather than maximum amounts. The Gas Water and General Investment Trust, Ltd., has the unusual provision that "not more than £25,000 can be invested in any one security except in cases of securities of which the company is acting as an issuing house, or where it is desirable to exceed such limit in order to protect an existing investment—or where such limit is exceeded by reason of amalgamation of undertakings in which the company has made investments."

The most common stipulation among the British companies is that not more than 5% of the issued share and debenture capital shall be invested in any one security or undertaking. Ten per cent is another limitation commonly imposed. A few companies, among them the Industrial and General Trust, the Army and Navy Investment Trust, the Alliance Investment Trust, and the Bankers Investment Trust, restrict themselves to 3% or 4%, and others set a figure giving broader discretion to their directors,—for instance, the First, Second and Third

Scottish American Trust Companies, Ltd. An interesting provision is to be found in the Articles of the Indian and General Investment Trust, Ltd.—“Not more than one-third of the subscribed share and debenture capital can be invested in any one class of securities, nor can the company hold as an investment more than one-fourth of the capital of any one undertaking.” Occasionally different conditions for diversification in investment are set for original capital, than for any raised subsequently.

It is often stated in by-laws and articles of association of investment trusts in the United Kingdom that there must be no investments involving unlimited liability. Frequently an exception is made under general standards of distribution in favor of securities issued in the United Kingdom or obligations of the British Government. Two companies declare that securities of different titles or denominations are not to be regarded as one security, for purposes of investment, merely because they are issued or guaranteed by one body. When the percentage of investment in any one security is fixed, as rarely occurs, in terms of issued debenture capital only, the effect is the same, for debenture capital bears a definite relationship to share capital, as explained elsewhere.

American investment trusts represent such variety of type, regardless of their scanty number, that their standards of diversification can best be studied in detail in Chapters XV and XVI. It is interesting to observe, however, that the International Securities Trust of America places an average of not more than  $\frac{1}{4}\%$  of its entire invested capital in securities of any one issuer.

**Geographical Distribution of Investments.**—Limitation of investment in securities issued in, or by, any one country, is not general among British investment trusts. It is likely that this would have been more common had organizers foreseen the disturbed political conditions following 1914. In those

few cases where it does occur there is lack of uniformity. The Debenture Securities Investment Company has this interesting Article: "At least 95% of the subscribed capital shall be invested in mortgages, mortgage debentures, debenture stock or bonds but not more than  $2\frac{1}{2}\%$  of the subscribed capital shall be invested in any one security, and the total investments in undertakings of *any one country*, except England, are not to exceed 2% of the issued capital." (*Italics supplied.*)

The question of geographical distribution has been more carefully considered in certain American trusts, among which the International Securities Trust of America has perhaps the most complete provisions (in the Amended Declaration of Trust). . . .

ARTICLE IV. (4) Of the total funds of the trust invested and available for investment by the Trustees, not more than seventy per cent (70%) may be invested at any one time in securities originating in the United States of America, not more than fifty-five per cent (55%) may be invested at any one time in securities originating in England, and not more than thirty-five per cent (35%) may be invested at any one time in securities originating in any other nation or country. Not more than ten per cent (10%) of the total funds which may be so invested in securities originating in any one country may be invested in securities representing any one distinct class of business or industry.

So long as the total funds of the trust invested or available for investment shall be less than One Hundred Thousand Dollars (\$100,000), not more than five per cent (5%) of the total funds which may be so invested in securities originating in any one country may be invested in any one such security; when such total available funds shall amount to One Hundred Thousand Dollars (\$100,000), but shall be less than One Million Dollars (\$1,000,000), not more than three per cent (3%) of the total funds which may be so invested in securities originating in any one country may be invested in any one security; and when such total available funds shall amount to One Million Dollars (\$1,000,000) or over, not more than one and three-fourths per cent ( $1\frac{3}{4}\%$ ) of the total funds which may be so invested in securities originating in any one country may be invested in any one such security other than governmental securities.

The trust shall never purchase or hold a majority in interest of any one issue of securities.

Provisions of similar tenor are to be found in the by-laws of the Financial Investing Company of New York. If, as seems likely, American trusts are to become a vital force in the export of capital from the United States, it is probable that increasing attention will be given to a proper international distribution of risk. Several potential foreign markets exist today for the absorption of American funds for every one with which British investment trusts were confronted forty years ago.

**Distribution of Risk by Type of Enterprise.**—Under Sections III and V of Appendix A a list has been given of certain British companies which are quasi-investment trusts, but which nevertheless confine themselves to investments in certain types of enterprises. As has been described above, they generally combine a promoting and financing, with an investment business. "Rails" are a particularly popular form of investment among trusts, and quite a number of companies devote themselves exclusively to railway, or to public utility companies, as in the United States. Tea, coffee, rubber, mines, realty and oil also have each their list of companies. Several American investment trusts, like the Bankstocks Corporation, and the Joint Stock Securities Company, are interested only in banking stocks of one kind or another. The investment trust, as a rule, however, does not specify so narrowly, nor does it limit its participation by type of enterprise any more than by geographical region. Confining its requirements to such conditions as are sketched above, it usually allows leeway to its directors in purchasing when and where the best terms are obtainable.

Among recent interesting developments in America are certain so-called "bankers share" trusts; and several companies formed to invest in particular European countries, which are a cross between financing companies and investment trusts. As will be seen in Chapters XIII and XIV these are hardly



investment trusts in the commonly accepted sense, although they are frequently referred to as such. In this connection it is worth while to note that neither the specialization of these "bankers share," or "trustee certificate" companies in securities of chain stores, oil companies, railways or what not, nor the exclusive interest of the above mentioned investing companies in particular foreign countries finds many parallels among the better known investment trusts of Great Britain.

**Distribution of Risk by Type of Security.**—It is safe to say that the greater part of all British investment trust capital rests in bonds or preferred stocks, and the purchase of British government obligations during the war tended to shift an even larger proportion to the fixed interest side. Nevertheless, the majority of investment trusts do not confine their purchases to fixed interest-bearing securities. In fact, the average investment trust list contains a larger proportion of unbonded and irredeemable securities than that of the insurance company or the commercial bank. In many portfolios, there may be found a considerable portion of common shares; while much lack of uniformity appears in comparative holdings of preferred shares and bonds. With a few exceptions,<sup>1</sup> there are no set conditions as to the proportions of the invested capital which may be placed in different denominations of securities.

**Extent of Diversification Not Always Revealed.**—It would be easier to see how broad a distribution of risk is to be found among their holdings if all investment trusts followed the policy of publishing their investments. Most American investment trusts have at one time or another, in their brief period of existence, cultivated public confidence by revealing their investments at a particular time, or by publishing a list of "approved securities" among which their purchases are made.

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<sup>1</sup> As with the British Investment Trust, Ltd., the Foreign & Colonial Investment Trust Co., Ltd., the Debenture Securities Investment Co., Ltd., and the Railway Debenture & General Trust Co., Ltd. The latter invests only in debentures and government loans.

Practices of publicity, however, are less common among the investment trusts of Great Britain where longer public experience of the advantages of this form of investment has created considerable confidence in the ability and integrity of those prominently associated with trust organization and management. Probably less than a third of the investment trusts of Great Britain take the public fully into their confidence by printing annual investment lists. While complete, such lists as are printed are often not classified, and there is usually no résumé for the convenience of the reader. A number of companies not publishing lists give a classified summary sufficient to exhibit main tendencies. Even where secrecy is observed, it is not likely that any trust would refuse to reveal its holdings to a stockholder if the request were properly made. In some cases it is understood that the list may be viewed by the stockholder on certain days at the office of the company, or if an appointment is made with the secretary for the purpose.

**Objections to Publication of Investments.**—The principal objection voiced by investment trusts to the periodical publication of their investments is that the facts thus broadcasted often subject them to gratuitous criticism on the part of ill-informed investors, while practical use is made of these facts mainly by brokers on behalf of their clients, or by competitive trusts not so well equipped to ferret out investment opportunities for themselves. Moreover, it is felt by many trusts that they would be handicapped in realizing the best price on their holdings if the knowledge of the extent of these holdings were public property. In the case of some investment trusts, the management by the directors along lines of their own experience means that revelation of the investments is to a certain extent a revelation of personal interests. Especially among promoting and financing companies there are obvious objections to such a procedure. For instance, the articles of association of

the British Empire Trust Company expressly provide that the directors shall not be bound to publish lists of the investments.

Finally, if there were no practical objection to the publication of investments, it should not be forgotten that among those investment trusts which consistently tend to shift the composition of their holdings, a published list of investments quickly becomes antiquated. It might also be observed that very few individuals have personal knowledge of more than a small fraction among the published holdings of any investment trust,—or the means of carefully analyzing even those securities with whose names they happen to be familiar. This is bound to be increasingly the case as foreign and domestic securities rapidly multiply in number, complexity and variety.

From this it must not be assumed that publication of investments is to be condemned. On the contrary, this practice has much to commend it, and is followed by some of the largest and most conservative of the British investment trusts. A number of the latter, however, would probably gladly abandon publicity of their holdings if the contrary precedent had not been established, and the writer has never observed that public confidence in British investment trusts is affected one iota by any decision which may have been reached concerning publication or non-publication of holdings.

**Distribution of Investments Illustrated.**—The investment portfolio of the majority of British investment trusts is truly cosmopolitan. The United States Debenture Corporation, for instance, has well over 400 distinct securities; the Investment Trust Corporation has 419 separate holdings, of which 399 are quoted in the official lists of London, New York or other well-known stock exchanges; the Scottish Northern Investment Trust reports over 470; the Northern American Trust Company has about 350; the Industrial and General Trust, Ltd., prints annually a complete list of its investments, 873 in 1925, which represent a capital of more than £6,000,000. Such broad

spreading of risk has not yet been attained by American investment trusts, with one or two exceptions to be noted in subsequent chapters.

There follow a few recent statements of British investment trusts showing distribution by class of undertaking, type of security, or locality.

#### GEOGRAPHICAL DISTRIBUTION OF INVESTMENTS

##### INDUSTRIAL AND GENERAL TRUST, LTD.—May 21, 1925:

Great Britain.....	38.13%
South America, excluding the Argentine Republic.....	14.35
Argentine Republic.....	13.07
British Dominions and Dependencies.....	12.73
United States of America.....	9.05
Europe, excluding Great Britain.....	4.87
Asia and Africa, excluding British Dominions and Dependencies ..	4.36
Mexico and Central America.....	3.44
	100.00%

##### SECOND INDUSTRIAL TRUST, LTD.—July 30, 1924:

Great Britain.....	30.57%
South America, excluding the Argentine Republic.....	17.54
Argentine Republic.....	20.86
British Dominions and Dependencies.....	11.90
United States of America.....	6.07
Europe, excluding Great Britain.....	6.65
Asia and Africa, excluding British Dominions and Dependencies ..	3.92
Mexico and Central America.....	2.49
	100.00%

##### INVESTMENT TRUST CORPORATION, LTD.—June 4, 1925:

Home securities.....	36 %
United States.....	20
Colonial.....	8
Argentina.....	10
Brazil.....	5
Other South American.....	9
Cuba.....	2
Central America.....	1.50
Mexico.....	1
Philippines.....	1
Spain.....	1
China and Japan.....	1.50
Other countries.....	4
	100.00%

##### THE UNITED STATES AND GENERAL TRUST CORPORATION, LTD.—1922:

Great Britain.....	37.9%
British Colonies and Dependencies.....	14.0
United States of America.....	11.6

South America:	
Argentina.....	16.4
Brazil.....	4.7
Other South America.....	6.7
Mexico.....	1.3
Other countries.....	7.4
	<hr/> 100.0%

## DISTRIBUTION BY CLASS OF UNDERTAKING

## INDUSTRIAL AND GENERAL TRUST, LTD.—May 21, 1925:

Industrial.....	47.67%
American and Foreign Railways.....	19.01
Banks and Financial.....	11.74
Government Securities and Municipal Loans.....	10.15
Home and Colonial Railways.....	5.67
Tramways and Omnibus.....	3.46
Land and Property.....	1.42
Shipping.....	.88
	<hr/> 100.00%

## SECOND INDUSTRIAL TRUST, LTD.—July 30, 1924:

Industrial.....	47.30%
American and Foreign Railways.....	19.83
Banks and Financial.....	8.59
Government Securities and Municipal Loans.....	9.82
Home and Colonial Railways.....	4.52
Tramways and Omnibus.....	8.17
Land and Property.....	1.57
Shipping.....	.20
	<hr/> 100.00%

## THE SCOTTISH NORTHERN INVESTMENT TRUST, LTD.—1922:

The funds of the Company are wholly invested in Stock Exchange Securities of 473 different undertakings, distributed as follows:

	£	s.	d.
1. Railway and Industrial Bonds and Stocks in the United States of America and Dependencies.....	154,431.	7.	11
2. Railway and Industrial Bonds and Stocks in Canada including Canadian companies operating elsewhere.....	168,259.	0.	2
3. Investments in Great Britain, including British companies operating abroad, War Loan Stock and National War Bonds.....	757,636.	17.	8
4. Bonds of Foreign Governments, Municipalities and Corporations, and miscellaneous investments.....	56,814.	7.	5
	<hr/> £1,137,141.	13.	2



## THE ANGLO-AMERICAN DEBENTURE CORPORATION, LTD.—1922:

	Amount Invested		
	Bonds £	Preferred Shares £	Ordinary Shares £
British Government Securities.....	417,049	—	—
Great Britain and the Colonies: Industrial and other companies.....	296,601	138,852	182,851
United States of America: Railway Companies.....	39,043	52,895	8,839
Tramway, Light and Power companies	90,767	44,714	677
Industrial and other companies.....	24,645	32,847	7,315
South American and Other Foreign Coun- tries: Railway Companies.....	123,879	13,315	56,081
Tramway, Light and Power companies	54,659	9,546	10,143
Government Securities and Industrial and other companies.....	69,089	18,233	48,039
	<u>£1,115,732</u>	<u>310,402</u>	<u>313,945</u>

## DISTRIBUTION BY TYPE OF SECURITY

## INDUSTRIAL AND GENERAL TRUST, LTD.—May 21, 1925:

Bonds, and Debenture and Guaranteed Stocks.....	40.29%
Preference Shares and Stocks.....	17.42
Ordinary and Deferred Shares and Stocks.....	42.29
	<u>100.00%</u>

## SECOND INDUSTRIAL TRUST, LTD.—July 30, 1924:

Bonds, and Debenture and Guaranteed Stocks.....	49.27%
Preference Shares and Stocks.....	14.17
Ordinary and Deferred Shares and Stocks.....	36.56
	<u>100.00%</u>

## THE INVESTMENT TRUST CORPORATION, LTD.—1922:

Bonds and Notes of Railways in the United States of America, in- cluding Street Railways.....	13.5%
Guaranteed and Preference Shares of Railways in the United States	3.2
Common Shares of Railways in the United States.....	1.1
Bonds, Debenture Stocks, and Guaranteed and Preference Shares of Railways other than in the United States.....	22.0
Ordinary Shares of Railways other than in the United States.....	2.0
	<u>41.8%</u>
Total in Railways, including Street Railways.....	41.8%
Bonds, Debenture Stocks and Guaranteed and Preference Shares of other companies.....	32.6
Ordinary Stocks and Shares of other companies.....	6.6
Foreign and Colonial State and City Loans.....	3.2
British Government Securities (£950,500 nominal).....	15.8
	<u>100.0%</u>

## UNITED STATES DEBENTURE CORPORATION, LTD.—1922:

Debentures and Bonds.....	61%
Preference Stocks and Shares.....	24
Ordinary Deferred Stocks and Shares.....	15
	<u>100%</u>

It is regrettable that for so many of the British companies figures are not accessible showing the spread of interests. Even if they were, any quantitative estimates would involve a laborious checking-over of unclassified investment lists.

Toward the end of 1924 the list of holdings of the International Securities Trust of America revealed 552 distinct investments issued by 407 different organizations. These organizations may be classified as follows:—45 railroads, 65 public utilities, 202 industrial companies, 52 foreign corporations and 43 governments or governmental sub-divisions. Of these investments 65% were bonds, debentures or evidences of indebtedness, 29% were preferred stocks and approximately 6% common stocks.

**Basic Soundness.**—It is a truism that investment trust management must consider not only the appropriateness of any proposed investment from the viewpoint of diversifying holdings but also from the standpoint of its essential soundness. This involves, among other factors, the consideration of book value in relation to market price, the dividend and interest record, and the circumstances accounting for any variations in such record.

A friend of the writer, who carries immediate responsibility for the portfolios of several Edinburgh investment trusts has recently been making special studies of the implications and results of our Railway Transportation Act; the real effects upon rubber output and price of the export restrictions imposed under the Stephenson scheme; and marketing problems in connection with Ceylon tea. His companies have been heavy purchasers of American railway shares and obligations, and are interested in rubber and tea plantations; but the most painstaking following of these commodities by no means relieves him of the necessity of protecting other avenues of approach to his portfolios. It cannot be too strongly emphasized that the investments must be watched in the concrete, and that dependence

upon market abstractions and financial indicators, however scientific, is at best a second line of defense.

**Diversification and Efficiency.**—It follows from this that the principle of distribution of risk, while the very foundation of investment trust policy, should not be carried further than the capacity of the analytic staff warrants. Beyond a certain point the minimizing of risk involved in scattering holdings may possibly be more than counterbalanced by the difficulties of efficiently wielding so complicated a portfolio. No human being working within ordinary limitations of time and energy can possibly give personal attention to more than a certain number of securities, although the advice of an alert and conscientious board of directors, and the organization of a competent statistical and research staff, may in the case of some investment trusts enable the managers safely to carry a very broad diversification.

In effecting distribution due attention should be paid to spreading the geographical risk, providing a variety of obligors, governmental and industrial, and assuming both proprietary and creditor positions by acquiring junior and senior securities. The political or other factors seriously affecting bonds or stocks domiciled in any particular country or issued in any currency will, however, in all probability influence in much the same way all types of security under certain broad categories. Forces which may be considered "bullish" or "bearish" in any commodity market or industry will operate differently only in degree among the main establishments providing these commodities or dominating these industries. Different phases of the business cycle will differently affect the claims to plant and goods represented in stocks, and the claims to money represented in bonds. In order to profit from these well known tendencies it is not essential to carry a confusing variety of investments, provided the various categories thus differently affected are adequately represented.

**Criteria of Soundness.**—The criteria of soundness applied by investment trusts in building up their portfolios are those in universal use. As a rule, these matters are left to the discretion of directors and management, and no attempts are made to hamper the exercise of their judgment. In the United States, as might be expected in the early stages of what is for this country a new development, restrictions are frequently imposed with the object of increasing public confidence in the undertaking.

Thus the trust agreement establishing the International Securities Trust of America, while necessarily leaving considerable discretion with the trustees, imposes in Article VI (Amended Declaration of Trust) certain investment restrictions of an interesting character:

(2) Upon receipt by them, from time to time, of monies from any source for the account of the trust, the Trustees as soon thereafter as they may deem practicable and desirable shall invest in marketable securities all of such funds then available for investment. No securities shall be purchased by or on behalf of the trust which shall not be eligible for acquisition by the trust under the terms of the Rules and Regulations which shall be adopted by the Trustees; and no securities shall be purchased unless:

(a) Reliable information shall be obtainable with respect to the history, management, assets, earnings and income of the governmental authority, corporation or organization issuing such securities:

(b) Unless the history of the nation or country in which such securities have originated shows financial stability and recognition of private property rights; and

(c) The governmental authority, corporation or organization issuing such securities shall have been established for a period of at least four (4) years.

The trust shall not purchase or otherwise acquire any of its Common Shares, nor shall it purchase or otherwise acquire any of its Preferred Shares or any of its bonds or other evidences of indebtedness except for the purpose of retirement and cancellation.

Furthermore—

(5) From time to time, the Trustees shall sell and dispose of all securities within one year after they shall have ascertained that such securities would not then be eligible for purchase by them hereunder.

**Underwriting, and its Relation to Purchasing.**—Before considering in the following chapter the problems of turnover in managing investment trust portfolios it will be useful to study a field of activity commonly developed among trusts in Great Britain and contributing materially to the soundness and yielding power of their investments. This is participation in underwriting syndicates, which, although as yet alien to most American investment trusts, constitutes a chief service of the British companies.

Following the division of labor so characteristic of the British financial system, the commercial banks do little underwriting. It is commonly the practice for underwriting agreements to be made through groups of companies or prominent financiers having personal, if not official, affiliations with investment trusts. The relationship enjoyed even by small companies with other trusts and financial houses, through their directors, secretaries, accountants or managers, gives them the advantage of combining underwriting fees with substantial investment opportunities. On the other hand, their connection with several investment trusts gives certain British firms and individuals surprising power of participating in promotions and underwriting agreements. A glance at some of the groups of Section I, Appendix A, will illustrate this. Thus while doing essentially an investment business, these companies at the same time incidentally lend their combined underwriting support to certain sound new issues.

**Underwriting Methods and Limitations.**—This is a business, however, which is handled with great tact and care. On the one hand, it might prove disastrous to link an investment trust too closely with any issuing house or firm of ambitious



private bankers. The days are past when the majority of the latter would saddle companies in their orbit with worthless or undervalued securities, but the danger is latent in too close connections of the sort. On the other hand, the management of a British trust cannot always afford to refuse co-operation, if the underwriting offer is a reasonable one, well within the criteria of the trust's participation. Knowing well the habits and standards of the several companies on his list of co-operating underwriters, the organizer of the syndicate may "put down" different investment trusts for reasonable participations as a matter of course, and refusal to accept the underwriting allotment in any case might involve the loss of further opportunities in the future.

In entering the underwriting field the British investment trust is interested in more than its fee. It rarely guarantees its quota unless it is convinced that the security would make an acceptable investment in case it becomes necessary for the trust to act upon its underwriting agreement. In this event a block of the new issue representing the amount of its quota is purchased outright, generally without resort to bank borrowing, and is retained as an investment at least throughout the probationary period, or until an advantageous market is found. The great majority of issues of a kind attractive to trusts are, however, readily absorbed. Trusts particularly anxious to invest in what they consider sound new offerings, therefore, formally reserve the privilege of buying a certain proportion of the issue, and their orders are then entered in the usual way on the brokers' books, and executed at what amounts, owing to the underwriting fee and the wholesale buying price, to a considerable discount.

**London's Financial Hegemony Dependent upon Investment Trusts.**—Few students of London as a financial center realize the great contribution made by investment trusts, whose underwriting services have introduced an element of stability

into her market for higher grade offerings. Whether new issues not encouragingly received by the public are initially quoted at substantial discounts depends in large measure upon the pressure for collateral loans exerted by underwriters in the banks, and upon their haste in "unloading" at sacrifice prices. It is estimated that the greater part of capital required during the expansion of corporate enterprise in the United States in the early years of this century was supplied by collateral loans of banks, which made it possible for promoters and underwriters to carry undigested securities until they had won their way to settled places on the exchanges. The participation of many investment trusts in London underwriting has lessened the risks in this form of business and contributed to the lower costs of flotation obtaining there,—a circumstance which has contributed in no small measure to the dominating position commanded by that market in pre-war years.

**Group Agencies Among British Investment Trusts.**—One of the strongest agencies offering to investment trusts the advantages of co-operative management and underwriting participations is Robert Fleming & Company, one or more of whose partners are closely associated with each one of the different trusts constituting the group bearing this name (Section I, Appendix A). This firm also serves as London representative of many Scottish trusts. Their senior partner, whose early affiliations were with Dundee groups, is an originator of the investment trust idea, and the part played by him in the development of American railways is well known in the United States. The first group of Section A comprises those investment trusts with which this firm is particularly concerned, and for whom they serve as eyes and ears in contacts with the financial world.

The British Trusts Association, Limited, is an interesting recent development. It is a corporation whose shareholders are financial and investment trusts and whose ninety-two participating companies are kept advised of new promotions and

share underwriting fees. Its officials claim that the British Trusts Association will also be in position to assist its members in safely distributing their investments; and the combined strength of the shareholding companies is such that the Association plays its part in underwriting many important issues, the nature of which is, of course, not always publicly known. The aggregate invested capital of the shareholding companies approaches £100,000,000—although the occasional connection of trusts with more than one group means that this is perhaps an over-estimate of the potential strength of the Association. Thus several companies of the first group of Section A participate in the British Trusts Association, although they also enjoy the services of Robert Fleming & Company.

There follows a published statement of the purposes of the British Trusts Association:

THE BRITISH TRUSTS ASSOCIATION, LIMITED, has been incorporated, as its name implies, for the purpose of enabling the various British Trust Companies to act together in the selection and acquisition of securities and as a central investigating organization.

The Association, as its modest capital implies, has not been formed with the object of trading on its own account, but primarily of acting as a medium for the thorough examination of any issues and propositions involving the provision or outlay of capital that may from time to time come forward, and particularly to negotiate to supply such capital to approved British concerns and enterprises.

The pooling of the financial experience and influence of the British Trust Companies is a feature of inestimable value in securing the closest investigation and correct appraisal of the value and desirability of securities and propositions of a financial nature.

It becomes more and more apparent that British finance apart from the Joint-Stock Banks, will be urgently called upon to support the efforts of British industry to regain and maintain its pre-eminent position in the world's trade, and it is particularly in respect of issues which will assist to this end that the Association will play an important rôle. In addition the Association will be prepared to consider the purchase of blocks of suitable securities which for various reasons, such as liquidation of estates, may have to be sold, distributing them

amongst its shareholders and thereby preventing the great disturbance of values which would result if they were thrown on the market.

The enormous power of the Trust Companies concentrated by means of the Association will carry great weight in leading and guiding the investment of British capital. In addition to this the combination brought about by means of the Association will provide a useful avenue for those seeking capital or the placing of securities by enabling them to address one central authority instead of each Member separately.

If after careful scrutiny and investigation the Directors of the Association are satisfied that a business offers proper safeguards, and inducements, they will offer participations to the Trusts and Finance Companies comprised in the list of Shareholders of the Association and where necessary form special Syndicates to deal with propositions which may require further development before the issue of the final securities.

It may also be anticipated that issues in respect of which public appeals are made and which are known to have been approved by the collective judgment of Members of the Association, will be more readily taken up by private investors. Further, by reason of the widespread activities of the various Trust and Finance Companies comprising the Association a broader field of investors will be secured. . . .

As the investment trust is itself a co-operative undertaking among individuals, so the British Trusts Association is an extension of this co-operative principle among investment trusts. The issues which it brings out, partially underwrites, or purchases, often constitute profitable investments for the associated trusts, which are through this central agency better able to acquire further holdings, or to liquidate what they may have.

The Association has grown rapidly since its organization. Starting with twenty members, it now has nearly one hundred shareholding trusts. Its issued share capital amounted to £18,000 in 1918 and has increased to £155,000 in 1924. Its balance sheets show an ever smaller proportion of assets as "cash at banks," and the greater part of its working capital is now in securities, although the rate of turnover and the proportion currently used on collateral loans is greater

than for the typical financial or investment trust. Unlike the latter, its income is derived in the main from commissions and underwriting profits. Further sources of earnings are interest and dividends on investments, trusteeship fees, and profit on realizations. Dividends on its ordinary stock (there is no preference or debenture) have averaged rather more than 8%, minus income tax, since its organization.

**Résumé.**—As described above, the British investment trusts and similar organizations have employed their capital of approximately £300,000,000 (see pages 9 and 10) in such a way as to encourage foreign investments of far larger amount. They are obviously but one factor in the mobilization of British savings, but they are nevertheless a most important element, and certainly the principal agency by which the conservative British investor makes his influence felt abroad.



## CHAPTER VI

### MANAGEMENT OF THE PORTFOLIO (CONTINUED)

**Static and Dynamic Points of View.**—There are two points of view from which an investment trust portfolio may be regarded—its composition at any one time, and its changing composition from time to time. At any given time the investments should in general conform to criteria mentioned in the preceding chapter; that is, they should be properly diversified and inherently revenue producing. But the managers of a trust ought not to let their vigilance lapse after shrewd initial investment, for diligent stewardship on their part calls for a gradual alteration in the composition of the investment portfolio even though the amount of capital remains stationary. In other words, the price at which the purchase of an otherwise eligible security is negotiated should not only afford reasonable return on the investment, but offer a fair prospect of economic profit.

**Turnover in Portfolio.**—The business of an investment trust is investing, rather than speculating, and its chief revenue is the current yield of its portfolio. For these very reasons, however, the kaleidoscopic phases of securities markets, varying from time to time in the same place, and from place to place at the same time, should be constantly studied with the object of readjusting the investment position and bettering the investment return. The sale of certain securities whose price represents a substantial advance over cost may be regarded as profit-taking; or, the reinvesting of the principal and realized appreciation in the approved investment trust manner may be viewed as a shifting from lower to higher yields in the employment of the trust's capital. So also may be viewed the disposal of investments netting smaller returns in order to purchase

issues which yield more, other things being equal; but operations of this kind may also be ascribed to the anticipation of profits in an ultimate resale of the newly acquired securities. From whatever angle we choose to view the turnover policies of investment trusts, it must be recognized that they are the very warp and woof of portfolio management.

**Individual and Investment Trust Estates Compared.**—In these respects the problems of the investment trust are similar to those of any individual or organization having a large moneyed estate to supervise. The difference between a "living trust," and what might be considered a "dead" one, is that in the former continual watchfulness guards against undue depreciation among investments even though it may not be consistently directed toward readjustments on a higher level of return. Provided its holdings are intrinsically sound, the investment trust is less concerned than the normal investor or trustee, about temporary depreciation in securities held, for there is generally capital to invest at advantage in a falling market<sup>1</sup> and the net decrease at such times is little, if anything, in the interest and dividends from a widely diversified portfolio. The comparative steadiness of the trust's income in periods of falling security prices—especially notable when, as is usually the case, the bulk of the investments are bonds and preferred stocks—saves it from embarrassment at any point of the market's gyrations. Unlike a marginal speculator, the trust is under no necessity of providing extra funds at unexpected "turns of the market"; its capital being derived for the greater part by sale of bonds and stock, and its activities being confined to investment, an investment trust faces

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<sup>1</sup> The following is quoted from the Chairman's remarks in the annual meeting of the Alliance Trust Company, Limited, at Dundee, April 17, 1925:

"Turning now to our capital account, you will observe that in issuing the balance of our authorised capital, we have reached a natural period in the policy of capital expansion initiated in 1921. At the beginning of that year Stock Exchange securities had suffered very heavy depreciation, and this company had, in addition, to accept the fact that conditions in its mortgage fields had become very bad, and that a period of increased arrears would have to be faced. One compensating factor, however, appeared to us to emerge, viz.: that as securities had sunk unduly, there was abundant room for the profitable use of money. We, accordingly, resolved not only to increase our borrowed funds, but to make an issue of new capital to the shareholders."

no unforeseen demands for liquid capital and no lurking threats of forced liquidation. In other words, while it should act quickly to avoid dangerous depreciation or to cut an irrevocable loss, the investment trust, as will appear in the next chapter, is in a very different situation from a trading or financing company whose "stock in trade" is, so to speak, the securities on its shelves, and whose annual losses or profits must be determined on the basis of calculated current valuation.

**The Investment Trust's "Bull" and "Bear" Markets.**—These are the circumstances which enable the well directed investment trust to sail so smoothly through troubled financial waters. There is a sense in which the "bull" market is "bearish" for a trust, and vice versa. At a season when the public are buying in anticipation of continued price increases, the investment trust may sell and realize its profit; at a time when pessimism prevails and the market is being evacuated by the timorous, it may take up sacrificed values at attractive prices, knowing full well its ability to await the periodic return swing. These are legitimate, and in the long run, dependable business profits. They are the result of a careful analysis of recurrent stock exchange periods of distribution and accumulation, and are to be expected as the reward of constant investment supervision.

The investment trust should enjoy decided advantages over the commercial bank in profitable investment. The latter has scanty funds for acquiring bonds when demand for commercial credit is brisk, that is, when rising money rates would presumably lower the quotations for interest-bearing securities. Conversely it is when trade is slack, capital is going into gilt-edged issues, and prices are buoyant, that the bank generally finds itself in position to increase its portfolio. Moreover, because of the many active international markets, an investment trust having wide buying connections will generally find profitable opportunities to acquire new investments in one bourse

while it is liquidating old ones in another, on the general principle that the times during which "bull" and "bear" tendencies assert themselves in the securities marts of different countries by no means correspond. The fact that there is often a wide divergence between the prevailing "tone" in any stock exchange, and the dominant price tendencies of individual listed securities opens up endless possibilities of profitable buying and selling in the same market at the same time.

**Detailed Study Required.**—No investment trust should base its expectation of turnover profits purely upon a study of speculation and credit cycle generalities. It is a problem, after all, of specific investments. If purchases are made with a view in each case of obtaining, as far as possible, an intrinsic or book value in excess of cost, opportunities will frequently arise for resale at a profit, irrespective of any reflex or sympathetic influence which general credit or monetary conditions may exert upon different securities. With any issue commanding an active market there is likely to be considerable spread between "high" and "low" over any period of time, and opportunities frequently occur for profitable turnover regardless of the prevailing tone of the market.

**Bargaining Advantages of the Investment Trust.**—The valuation which a myriad forces of demand and supply create for any security at a given time is as much the result of individual miscalculations as of objective analyses. If an investment trust buys an undervalued security and later disposes of it at a figure representing the intrinsic value, it profits from the mistake or need of the original seller; if the trust buys at a price consistent with book value and sells at an advance tantamount to over-valuation, it profits from the mistake or over-optimism of the buyer. In any case the investment trust, with its detached viewpoint and its skilled management, is not easily stampeded, and can more than "hold its own" in a market beset by innumerable conflicting forces.

**“Business Profits” in Investment.**—Business profits, in addition to fair average yield on investment, are, therefore, as much to be expected in an investment trust as in any other field of activity. It is a truism that any successfully run establishment should provide the market rate of interest on capital employed there, and further earnings resulting from the exercise of managerial talent. The investment trust is no exception to this general rule.

Before examining in greater detail the problem of turnover in investment trust portfolios it may be well to recapitulate some of the foregoing by quoting a few passages from Professor Arthur Stone Dewing’s article in the *Harvard Business Review*, July, 1923, on “The Rôle of Economic Profits in the Return on Investments” which expresses similar truths in different phraseology. Referring to the several elements entering into the price of a security, Professor Dewing says:

There is a certain component part represented by the pure interest, the riskless price of capital. . . . There is also an amount represented by the current market’s estimate of the risk of loss involved in the particular investment, an insurance premium to compensate for the possible loss of principal or interest. . . . And there is, finally, a certain increment or profit which accrues to the investor who acquires an investment carrying with it a higher premium than the actual or mathematical value of the particular risk requires. This third element represents the reward of business or managerial skill in the selection of an investment whose intrinsic merit is greater than the market estimate; or, to phrase it differently, the real risk is less than what the market price gages it to be. . . .

Furthermore, in the light of this analysis the problem of investment, considered as a business, narrows itself down to the selection of those investments which carry positive business profits. In other words, investment is a business like any other economic activity. Like a corner grocery store or a steel mill, it is subject to good and to bad management. If a fund is invested with skill—like the grocery or the mill—a true business profit will result, which, if not drawn out, will represent regular accretions to the fund, just as the profits of any business undertaking, not drawn out, add to its capital. . . .



The importance of intelligently directed investment trusts in thus properly managing investments becomes clear in further excerpts from the same article:

The application of this theory is dependent obviously on the control over funds of sufficient size such that individual losses may be compensated for by the aggregate premium reserves. This requires a considerable distribution among different industries and different issues of securities because the individual units of investment, such as thousand-dollar bonds and hundred-dollar shares of stock, are of considerable size. . . . Investment distribution . . . is . . . the only practical means in the United States, for creating something approximating a balance between the certain losses and the aggregate of risk premiums. Some such balance has to be created before the profits or the losses due to the exercise of business ability show themselves.

It is the same old story, long exemplified in all kinds of insurance, that the totality of chances must be of sufficient size so that the so-called law of averages, the strict mathematics of probability, takes the place of mere chance. . . . Throughout this study we have been considering investment as a business or a science to be conducted with the intention of devoting to it the study, care, attention to detail, and devotion that is required to make any business a success; in other words, we are considering the administration of the investment of funds with the explicit purpose of obtaining not only pure interest and such premiums as will balance the losses but also a positive business profit as well. These principles, however, apply only to investment on a large scale with this explicit purpose; they do not apply to the investment of small personal funds. . . .

**Specific Application of Foregoing Principles.**—In order to give specific application to these principles, there may now be considered the several factors which, acting separately or conjointly, offer to the investment trust its peculiar opportunities for realization profits.

**I. THE AGE FACTOR.**—The cable address of a great London firm having much to do with investment trust management is "Fledgling Stock." It is the practice among British trusts to acquire securities comparatively new or unknown, provided their analysis proves the "fledglings" capable of later

"flight." Between the real value of some issues, and the estimate which an uninformed public puts upon them, there is occasionally a broad margin. Because the investment trust is *par excellence* a discriminating investor, it may often buy cheaply by subscribing at the time of the underwriting arrangements; or again, where an issue has failed and hangs on the guarantors' hands, the opportunity occasionally comes to acquire lots at a substantial reduction from the figures at which the underwriters acquired them. This frequently happens for reasons not connected with the real value of the security, which, after a few months or years of nursing, may find its true level on the exchanges.

Many issues have thus, either at the beginning or some time in their career, graduated from the investment trust portfolio, and left a substantial capital profit to their former owners when they became able to make their own way in the world. The investment trust has in this way been the chief means of infiltration into the United Kingdom of securities which otherwise the mass of investors would not have learned to handle. There is every reason to anticipate that American trusts will become equally serviceable in introducing foreign securities to our public, and in carrying new domestic issues until they ripen into full public approval. The gains accruing to them in this process will be a just reward for intelligent economic service.

2. THE DISTANCE FACTOR.—For investment trusts having international buying ramifications there is rarely a time when advantageous use cannot be made of capital obtained from the home or other favorable markets, in countries where comparative scarcity of loanable funds results in higher interest rates or lower security values. The origin of many British investment trusts, in fact, may be traced to the substantial margin between home borrowing and foreign lending rates. American investment trusts and financing companies are now being organ-

ized to take advantage of the investment opportunities afforded by European, and especially German, industry and finance. Post-war scarcity of capital, especially in Central European countries of stabilized exchange, is one of the outstanding facts of this decade.

International arbitraging has not eliminated, even in these days, the variations in yield offered by the same, or substantially similar, securities because of the differences in market valuation from one country to another. It is such conditions as the following, sketched in the *Economist* (London) of June 20, 1925, which redound to the profit of investment trusts maintaining a watchful eye upon the principal world bourses:

*Investment Yields in London and New York*—The greater the yield the greater the risk is a time-honoured proverb of investment finance; but on certain investments an increased yield may easily be obtained without varying in any way the security behind them, in some cases without changing even the title of one's holding. The class of investment referred to is foreign loans, and an investor possesses at present an opportunity of improving his income without additional risk on account of the different price levels existing in London and New York. Herewith is a table giving a comparison of certain foreign loans (A) in London and (B) in New York, with corresponding yields:

A—London				B—New York					
		Yield					Yield		
	Price	£	s.	d.		Price	£	s.	d.
Argentine 5%, 1909.	91	5	15	0	Argentine 6%, 1957.	96½	6	5	0
Austrian 6%.....	94½	6	10	0	Austrian 7%.....	99	7	2	0
Chile 5%, 1911 (2nd)	87	6	1	0	Chile 7%, 1942.....	101¼	6	17	6
Dutch E. Indies 5%.	99½	5	0	0	Dutch E. Ind. 5½%,				
German 7%.....	100½	6	19	0	1953.....	100¾	5	9	0
Norway 6%.....	105	5	13	0	German 7%.....	96¾	7	5	0
Seine 7%.....	101	6	18	0	Norway 6%, 1952...	100¾	5	19	0
P. L. M. 6%.....	86	7	2	0	Seine 7%.....	89½	8	3	0
					P. L. M. 6%.....	79	7	15	0

The loans selected for purposes of comparison have behind them a similar standard of security, and are of approximately the same maturity. In some cases (e.g., Austrian, German, P. L. M.) the comparison is made between the London and the New York issues of the same loans. Prices are the higher (or buying) prices ruling in London and New York respectively at close of business on June 11,

1925, when this statement was prepared; yields are, without exception, redemption yields, and are calculated to the nearest sixpence. It will be seen that in every case it would be to the advantage of the investor to exchange from sterling into dollar bonds, and in some cases—Austria, Chile, Seine, and P. L. M.—the enhanced yield obtainable is very attractive. There seem to be few, if any, disadvantages in adopting the suggested conversion.

3. THE CREDIT CYCLE FACTOR.—Previous paragraphs have already sketched the position of an ably managed investment trust in contrasted phases of the credit cycle. Not only do securities representing different types of issuers (governments, public utilities, industrials, and so on) react in varied ways to fundamental market undercurrents, but investment trusts may study with profit the behavior of junior and senior securities at different points in the cycle.

It is interesting to observe that an investment trust was successfully launched in London in 1924 with the avowed intention of taking full advantage of changes in market value due to the periodical swings of the business cycle. It is worth while at this point to quote a few explanatory paragraphs from its prospectus (issued in January, 1924) :

#### THE INDEPENDENT INVESTMENT TRUST, LTD.

This company has been formed . . . to carry on the usual business of an Investment Trust company, aiming at obtaining a higher return on the capital employed than is open with safety to the individual investor, and also having special regard to certain principles of investment which are now well recognized but have as yet been acted on in only a limited measure. It is now known that fluctuations in the relative values of long-dated and short-dated fixed interest securities and also of fixed interest securities generally and of ordinary shares are all affected by the periodic credit cycle. Changes in the short period rate of interest affect the value of long-dated securities to a greater degree than should strictly be the case, with the result that considerable profits can be made by changing from one class to another at the appropriate phases of the credit cycle. Similar periodic changes also take place in the relative values of money on the one hand and of goods and real property on the other, which are reflected in the rela-



tive values of bonds and of shares, representing as these do respectively money claims and property, so that here also the same principle of changing from one class to another at appropriate times can be applied.

The result of accumulated experience on these matters is to make it clear that the course of events is sufficiently regular to enable those who are in close and constant touch with the financial situation in certain instances to anticipate impending changes in the course of the credit cycle.

Whilst the directors will carry on the business of the Company on the stable lines recognized by sound Investment Companies, they intend in addition to avail themselves of the above principle by moving from one category of investment to another whenever the general situation indicates such a change to be advisable. This does not imply any intention to adventure the funds of the Company upon investments which would not be considered suitable for a prudently managed Investment Company. Indeed, the policy of moving from time to time from one category of investment to another will require that the funds of the Company should in the main be employed in investments which are readily marketable, and which are among the leaders of their class. It will be the object of the Directors to create an organization which will enable the ordinary investor who is unable or does not desire to pay constant attention to his individual holdings to obtain all the advantages of close supervision of his investments.

The distributable income of the investment trust being generally derived from revenue accruing upon its investments, rather than the profits of turnover, realization of such profits by the sale of securities in the investment trust portfolio is of varying importance from company to company and from time to time, as determined by general market conditions and the greater or less speculative composition of the portfolio. It is not always to redistribute investments upon a higher yield basis that the investment trust enters the market as a seller. At times it desires to evacuate an unsafe position, to minimize a probable greater loss by accepting an immediate smaller one, to withdraw from issues expressed in fluctuating or falling currencies, or merely to obtain funds for acquiring promising new issues,



or for covering disproportionate portfolio risks by buying securities of other currencies or other markets. In all of these operations the credit cycle should be studied.

4. THE RISK FACTOR.—It has been said that investors may be divided into two classes, those who pay too much for poor securities, and those who pay too much for good ones. There is no reason why the investment trust should enter either of these categories. The struggle for safety of capital has resulted in patently over-valuing certain "gilt-edged," or "trustee" securities. The investment trust will as a rule avoid investments of this character, not only because diversification introduces the law of average in protection of principal, but because the element of risk in any security can be thoroughly probed, and a price paid for it—if it is purchased at all—which, when adequate allowance is made for pure interest return and premium against the particular risk involved, will offer a fair prospect of economic profit.

The investment trust is, therefore, in an entirely different position from the savings bank, which under the laws of our several states must confine its investments to certain classes of "safe" securities. By affording safety in entirely different ways the trust diverts some of the demand which would otherwise be concentrated upon the "legals," or "trustee securities," but which is sufficiently potent in any case to make the latter generally a poor "buy" for investing companies.

The following is quoted from Professor Arthur Stone Dewing's article mentioned above:

The opportunities for exercise of marked business ability in selection of investments are less in the widely known than in little known securities. . . . Or from practical points of view of exercise of business judgment, there is no group which, as a whole, affords so consistently poor investments as the so-called "legals" for New York and New England savings banks. . . .

It is distinctly unfortunate that American financial practice has not imitated at least the form of the English investment trust or corporation. Through the instrumentality of these investment agencies

the small investor is able to obtain the two important things almost always lacking in the administration of a small fund. He has the detailed attention of a man or men who make investment a business, a main intellectual and economic interest. He also obtains adequate distribution of risks no matter how small the principal of his fund may be. The nearest approach is the New England savings bank, but, unfortunately, officers of savings banks are chosen more for their respectability, family connections and age than for either business ability or knowledge of investments. Savings bank investments are also determined by arbitrary state laws, representing, for the most part, the vague and uncritical investment sentiment of the preceding generation.

The tendency to overvalue "trustee" securities is well illustrated in the normal effect, upon current market valuations, of "splitting" stock into prior and residuary shares, and selling the former as a "trustee" security. This circumstance, treated more fully in Chapter XIV, is illustrated in the following quotation, from the Chairman's remarks in the meeting of the "Railway Investment Company," in March, 1925:

We are, again, in this company, face to face with the fact that the London Midland and Scottish Ordinary stock with, as I believe, as good standard revenue income prospects, attached, however, entirely to one large consolidated stock, commands only 91½ per cent, whereas London and North-Eastern, divided into three classes, one available for trustees, carrying 4 per cent, a second receiving a well-secured standard revenue of 2½ per cent, and a Deferred for the balance, commands 120 per cent. That great discrepancy is very apparent to us from our holdings being in the two railways. Our proposals are, as far as practicable, to rectify this by supporting the new large consolidated trust, which will embrace our holding and that of others of London Midland and Scottish Ordinary stock, with income apportioned to three different securities

The philosophy of investment trust buying is admirably summarized in the following excerpts from the Chairman's address at the annual meeting of the "Investment Trust Corporation, Limited," held in London on June 4, 1924:

We have, as I have said, in all 419 different securities. In the course of the 36 years of the life of the company we must have had, I suppose, one or two thousand. Next to none of them, excepting our war investment in Government bonds, have been what are known as trustee securities. To buy these does not require the intervention of an investment trust company. We run greater risks than in trustee securities, and continually strive to combine two things which are usually held to be incompatible—namely, high interest and good security. In a list of 419 such investments some unforeseen trouble may be reckoned as certain to arise now and then.

I heard the view expressed the other day by the chairman of a leading trust company that defaulted securities constituted an item somewhat similar to a bank's hidden reserve. They do not appear at all in revenue account, and in a capital valuation they appear at a very low price. On the whole, if they represent intrinsic values, they are likely to get better rather than worse, both from a revenue and capital point of view, as time goes on. But, in any case, we try to keep these irregularities as low as possible, while not forgetting that the central idea of an investment trust is to increase security and profit by a careful selection and a wide distribution of risks.

*Comparative Investment Value of Senior and Junior Securities.*—A number of recent studies have undertaken to analyze the comparative investment value over a period of years of common stock, preferred stock and bonds. For detailed analyses the reader is referred to studies made by students of the Harvard Graduate School of Business Administration, and referred to in the *Harvard Business Review*. Of significance are also the studies of Edgar Lawrence Smith, President of the Investment Managers Company, who, in a summary of conclusions reached in his book "Common Stocks as Long Term Investments," states that:

In a study from 1866 to date, I have been unable to find any twenty-year period within which a diversification of common stocks has not, in the end, shown better results, both as to income return and safety of principal, than a similar investment in bonds. It was a surprise to me, for my studies were undertaken with the intention of proving the probable future advantage to be gained from bonds over stocks.

This bond tradition, if I may call it such, was supported by experi-

ence up to 1897, when the purchasing power of the dollar reached its highest point. But the experience of investors in real estate mortgages and in mortgage bonds, with respect to a depreciating currency since 1897 and a rising interest rate since 1902, raises grave doubt as to the justification of this tradition, with particular reference to personal as opposed to institutional investments. Because common stocks are regarded as speculative, they are omitted entirely from the lists of a great many investors. . . . Well-diversified lists of common stocks, selected on simple and broad principles of diversification, respond to some underlying factor which gives them a margin of advantage over high-grade bonds for long-term investment.

There is furthermore formulated by the same author the following:

#### LAW OF INCREASING STOCK VALUES

1. Over a period of years the principal value of a well-diversified holding of the common stocks of representative corporations, in essential industries, tends to increase in accordance with the operation of compound interest.

2. Such stock holdings may be relied upon over a term of years to pay an average income return on such increasing values of something more than the average current rate on commercial paper. . . .

In the selection of securities for investment, we must consider more than the expected income yield upon the amount invested, and may quite properly weigh the probability of principal enhancement over a term of years without departing from the most conservative viewpoint.

There seems little doubt that if reasonable care is exercised to choose undertakings enjoying the prospect of increasing social demand for their products, and if participations are widely enough diversified, common stocks make a desirable investment in the long run. In the preceding chapter it has been seen that certain representative British investment trusts have from a very small proportion to as much as 40% or more of their investments in common shares. A number of American investment trusts practically confine their investments to common shares. (See Chapter XVI.) If it is asked why a greater average proportion of deferred stocks is not found in investment trust portfolios, it must be borne in mind



that trust assets are not immobilized, that variations occur in prices of senior as well as junior securities, and that stability of income may at any time be assured by a preponderance of bonds and preferred shares at the same time that full advantage is taken of market variations for the realization of capital profits in the course of profitable reinvestment.

5. MISCELLANEOUS FACTORS.—Examples might be multiplied indefinitely of the ways in which investment trusts enjoy an advantage over the average buyer, whose operations so potently affect the markets. Strikes, political disturbances, exchange fluctuations, and a variety of other factors are continually causing erratic changes in market valuations, and the prospect of the investment trust's gaining rather than losing by these random circumstances depends upon its holding power, foresight, and economic knowledge as compared with the general public.

*"Nursing Investments."*—Of importance is the peculiar capacity of the investment trust to take such steps in the protection of its holdings as will translate into market values the enhanced earning power resulting from better organization. To quote one London authority:

Since the boards of investment trusts are often behind the scenes in regard to what is happening to defaulting bonds and debentures, there are occasions when it is wise for them to purchase these silent securities for the sake of capital profit, which is sometimes a practical certainty within a comparatively short time.

The investment trust is a strong bulwark for the present financial system, in that its interests always square with those of the individual purchasers of corporate securities. It cannot afford to leave unprotected any policy which it regards as unsound, though its participation is so small that its activity is largely a matter of principle. The fact that it often holds more than one class of security in the same enterprise means that it naturally takes a broader view than the individual investor, and



is more inclined to "hold the balance evenly between the different classes of capital." This phase of the activities of the investment trust is at one with the principal functions of such bodies as the British Corporation of Foreign Bondholders and the Belgian Association Pour La Défense des Détenteurs de Fonds Publics.

A case in point arose in 1924 with the financial difficulties of a large Scottish warehousing corporation. The proposal to modify unfavorably the status of the preference stock, which was accepted in a nominal poll of the shareholders, was vigorously opposed by a representative of the Industrial and General Trust and other British investment trust companies, who expressed himself to this effect at a special meeting of the warehousing company, as quoted in the *Financial Times* of London, July 15, 1924:

. . . The interest of the trust companies which he represented was 8,467 preference and 5,839 ordinary shares, so that as their ordinary shares cost them a premium, they had invested nearly the same amount of money in each class. They were fighting for the rights of all preference shareholders, present and future.

The trust companies had no personal axe to grind. . . . As the ordinary shares were practically valueless at the present time, both as to capital and dividend, the preference shares ought not to be forced by one block of ordinary shares to surrender for the benefit of those ordinary shares and for only a nominal consideration the large sums due to them in cash. It was the intention of those whom he represented to apply to the courts for protection and up to date he had the written authority of some 700 shareholders to express their disapproval of the scheme. They were pressing this opposition as a matter of principle with a view to preventing the perpetration of another scandal of a like nature on unsuspecting preference shareholders of other companies in the future.

In thus carrying the matter to the courts the trust companies were in this case bearing the burdens and fighting the battles of the preferred shareholders, at the same time that they invited support from independent interests without cost or risk to the latter.

**Advantages of Portfolio Turnover Recognized by American Investment Trusts.**—In view of the foregoing considerations, and following in this respect the universal practice of British trusts, American investment trusts,<sup>2</sup> almost without exception, leave considerable discretion to their directors in altering the composition of their portfolios. Pertinent quotations are here given from the by-laws or trust agreements of several:

INTERNATIONAL SECURITIES TRUST OF AMERICA  
Amended Declaration of Trust

ARTICLE IV

Section 5. From time to time, the trustees shall sell and dispose of all securities within one (1) year after they shall have ascertained that such securities would not then be eligible for purchase by them hereunder. The Trustees, in their discretion at any time and from time to time, may sell and dispose of any securities belonging to the trust, and may invest and reinvest in accordance herewith the proceeds received therefrom.

THE BOND INVESTMENT TRUST<sup>2</sup>  
Declaration of Trust

The Trustees shall have full power and discretion to sell, exchange, transfer and convey from time to time, at public or private sale, any part or all of said Trust Fund upon such terms and conditions as they see fit, and the purchaser from them shall not be responsible for the application of the purchase money, and to invest the proceeds in the same manner and upon the same terms as the original fund.

THE MORRISTOWN SECURITIES CORPORATION<sup>2</sup>  
Certificate of Incorporation

To such an extent as permitted to business corporations in the State of New York, and not otherwise, to purchase or otherwise

<sup>2</sup> As explained heretofore, the "bankers share" or "stock conversion" companies,—Chapter XIV—are not classified in this work as investment trusts.

acquire, become interested in, hold, sell, mortgage, pledge or otherwise dispose of or turn to account or realize upon all forms of securities, including stocks, bonds, debentures, debenture stocks, notes, evidences of indebtedness, certificates of indebtedness, certificates of interest, commercial paper, mortgages and other similar instruments and rights, issued or created by corporations, domestic or foreign, associations, firms, trustees, syndicates, individuals, governments, states, municipalities or other political divisions or issued or created by others and to deal in and with the same and to issue in exchange therefor or in payment thereof, its own stocks, bonds or other obligations or securities or otherwise to pay therefor; to exercise in respect thereof any and all rights, powers and privileges of individual ownership or interest therein, including the right to vote thereon and to consent or otherwise act with respect thereto; to do any or all acts and things for the preservation, protection, improvement and enhancement in value thereof or designed to accomplish any such purpose and to aid by loan, subsidy, guaranty or in any manner those issuing, creating or responsible for any of such securities, all to such extent as permitted to a business corporation under the laws of the State of New York.

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#### INVESTMENT MANAGERS COMPANY<sup>3</sup>

##### Indenture

#### ARTICLE III, Section I

The Company shall have absolute control and management of the Investment Fund, except as herein otherwise specifically provided, and the Company shall cause the investment fund to be invested and reinvested from time to time as the Company may in its absolute discretion deem to be for the best interests of the Investment Fund. . . . subject only to the following restrictions. . . .

**Size and Efficiency of Investment Trusts.**—The brief discussion in this and the preceding chapter of the technique of investment trust management, will have suggested to the reader at several points the advantages of ample capital. Only if large funds are available for investment can underwriting be safely accepted, while economies in purchasing and substantial profits in realization are often the result of large-scale

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<sup>3</sup> For details concerning this and other American investment trusts see Chapter XVI.

buying. In any case the development and maintenance of an adequate managerial staff necessitates a considerable volume of capital if overhead is to be met on a reasonable percentage allowance for administrative costs (see Chapter IX).

Nevertheless, the first thing one is likely to observe in perusing the list of British companies is the moderate size of a majority of the investment trusts. Section II of Appendix A shows the average total outstanding capital of these companies to be only £1,200,000 in 1912 and £100,000 more ten years later. As compared with banks and industrial companies, this capitalization seems small for companies whose business is investment, and the turnover of whose funds is as a rule comparatively slow. Moreover, in quite a number of cases new companies have been organized when the time came further to expand capital after a certain size had been reached. This is true of such Scottish trusts as the Edinburgh Investment Trust (followed by the Second, and Third Edinburgh Investment Trusts), the Scottish Investment Trust Company (followed by the Second Scottish Investment Trust), and a number of others. There are several reasons why the administrative economies of larger average capitalization do not seem to be more generally enjoyed by investment trusts in Great Britain.

1. INTERLOCKING DIRECTORATES AND JOINT MANAGEMENT. —The grouping of the first list in Appendix A shows how common are interlocking directors and joint managers in the United Kingdom. One staff or one firm of accountants, in many instances, manages several trusts; for though these are legal entities, their offices and forces are merged. If a policy of active turnover is not pursued, one able executive can direct the work of the few clerks required for the routine. Where it is to the advantage of the trust to shift its investments, or where profits can be made on realizations, the most astute management is required. Even so, one or two secretaries or managing directors can exercise their skill for several companies at the

same time, especially if the needs of their investment business are similar. Thus numbers of British investment trusts are run with the economy of one, and though of modest size, they enjoy the advantages accruing from group management of their combined capital.

2. TRUSTEE RESPONSIBILITIES OF DIRECTORS.—The smaller size of British trusts makes it possible for those responsible to stockholders to watch continually every aspect of the trust's business. In many cases the direction is a personal affair, and the board is expected to keep informed of the general distribution of the trust's assets. Even a small capital is split into many investments. By making an executive of several companies responsible to different boards of directors, a professional management may be checked through the knowledge possessed by each board of directors of the investments of its own trust. In Scotland the creation of new trusts is also an appeal to the "canny" investor, who desires to distribute his risk in several legally independent companies. Trustees are especially interested in the further security which this seems to afford. As touching security, however, such separation seems a legal fiction if the successive companies are under the same management; and the informed British investor dips into those companies whose personnel he has reason to trust, giving little attention to the foregoing factors.

3. PROFITING FROM EXPERIENCE IN CAPITAL REORGANIZATIONS.—The chief reason for the splitting of capital into several companies among British trusts is frequently the desire to obtain new articles of association and thus to benefit by the experience of the parent company without altering its traditional policy. It may be thought advisable to change the conditions of investment (see Chapter V). In other cases, a readjustment of the ratio of common to preferred stock, or of both to debentures (see pages 46 to 48) is sought in the interest of ordinary stockholders. For instance, the Second Scottish



Investment Trust was organized to obtain a more favorable distribution of its classes of capital. In the original company the share capital is divided into 50% preferred stock and 50% deferred stock—while the borrowing power is limited to 50% of paid-up capital. In the Second company, the share capital is divided into 60% preferred and 40% deferred, and the borrowing power is 100% of the share capital. In the history of the Edinburgh Trusts, given in Chapter X, there appear the different policies pursued by the same management in the distribution of dividends, the creation of reserves, and the issue of bonus shares for the several companies of their group. Much has been learned in this cautious experimenting, made possible by the co-management of several trusts.

4. INCREASING GROUP CAPITAL.—The occasion for increasing group capital may be unusual opportunities for obtaining desirable additions to the investments, or the favorable position of the market from a borrowing standpoint, or both. The most convenient means may be offering debenture obligations, or ordinary or preferred stock in a new trust. It is enough to note that in determining the means of selling its shares and the proportions of common and preferred to be issued, as well as the amount, maturity, redemption and offering price of its bonds, the organizers must be guided not only by the prevailing capital market, but also by the prior experience of other companies of their group.

Whether investment trusts will be organized in the United States under group affiliations resembling those of British companies, only time can tell. In Chapter XV the reader will find the germ of the group idea in one or two American developments, especially the American Founders Trust, but it is the opinion of the writer that the average capitalization of American trusts will tend to be greater than that of similar British companies.

**Duties of the Investment Trust Executive.**—In concluding our bird's-eye view of the problems of investment trust management, it may be useful to summarize the duties of the executive as they have been touched upon at various places in the two foregoing chapters:

The investment trust management must follow not only the dividend and interest record of the investment trust's holdings, but also the circumstances which account for changes in return on investments.

The investment trust management should watch stock exchange quotations and other financial indicators with a view to formulating "turnover" or reinvestment policies.

The investment trust management must be prepared to take vigorous steps for the protection of any class of security held.

The investment trust management must watch the issue of new and refunding loans with the intention of obtaining a certain amount of conservative underwriting and acquiring desirable investments at low cost. (This applies only in countries like England, where investment trusts engage in underwriting.)

The investment trust management should recommend the means and the occasion for increasing the company's capital, or altering its composition.

The investment trust executive must, therefore, command unusual ability and experience. If efforts of the managers are to be effective, they should be granted discretion reflecting the great confidence which the directors impose in them. To this end, it is desirable that administration should be directly represented upon the directorate. This is very often the case in the United Kingdom, and is the rule among American trusts, which thus enjoy greater flexibility in management.

## CHAPTER VII

### ACCOUNTING PROBLEMS

**Questions Stated.**—Organizers of investment trusts in the United States will be confronted immediately with a number of accounting problems which not only concern sound administration but are also of considerable importance in determining the attitude of investors and the general public toward undertakings of this sort. Some of these problems are common to all business corporations, and others arise from the peculiar character of an investment trust's activities. Brief attention will be given in this and the subsequent chapter to a few questions which must be frankly faced, and the answer to which will involve reconsideration, in somewhat different terms, of the nature of investment trust activities and the precedents afforded by British experience. These questions are :

1. What relationship should obtain between the market and the balance-sheet valuations of investment trust portfolios? How should the latter be determined?
2. Should profits on turnover be distributed? If not, how should they be accounted for?
3. Is an investment trust justified in paying dividends at a time when the market valuation of its portfolio is shrinking?

In discussing these and related problems it will also be necessary to deal with certain other phases of investment trust accounting.

**Balance-sheet Figures and Market Quotations.**—The first problem which presents itself is that of the relationship between the figures at which the trust's investments appear in the published balance sheets and the actual market value of the same at

the time of audit and publication. Should these figures be a faithful reflection of current quotations? Do principles of accounting practice generally obtaining in American business apply with equal force to the investment trust, or are there special circumstances warranting departure from accepted policies?

Although the investment trust gradually alters the composition of its portfolio as conditions prove favorable, its securities, as stated in an earlier chapter, are in no sense to be considered as "stock in trade." It is not primarily an issuing or dealing house; profits from turnover, although often very considerable and at times equivalent to a substantial increment in its income, are generally of secondary importance as compared with the dividend and interest yield. Diversification of the trust's investments makes this yield reasonably dependable, and perhaps in the majority of investment trusts it is alone sufficient to meet all ordinary charges of administration and to net a fair return to the bond and shareholders. Fluctuations in current market value, except in so far as these faithfully reflect changes in the earning power represented by its securities, are, therefore, of less consequence to the investment trust than to the security dealer or the financing company.

**Two Causes of Market Fluctuations.**—For this reason it is useful to make a distinction in theory, if not in practice, between those general market factors affecting the values of all securities regardless of the earning power of specific stocks or the soundness of particular bonds, and those special factors taking account of these differing circumstances and thus affecting in diverse and often mutually offsetting ways, the variations in value of numerous items among the investment trust's holdings.

Among the former factors are longer term variations in interest rates, indicative of the relative abundance or scarcity of loanable funds, and under a sound monetary system con-

comitant in a certain measure with the succeeding phases of the business cycle. Here also should be classed those influences, so inscrutable as to nature, but so tangible as to effect, which the jargon of the market often calls a "general wave" of "optimism" or "pessimism" as the case may be. When accompanied by abundant funds for marginal buying, or temporary investment, the "bullish" forces of public confidence cause many securities at times to rise even above the exalted level of their fellows, and to assume a market strength entirely unwarranted by their comparative earning power and book values. Exactly the opposite happens under reverse conditions.

Among the latter factors, those reflecting intrinsic earning power, are not only the crude interpretation which the market makes of the condition and prospects of particular establishments, but also that complex of forces determining the public and professional estimate of the outlook for the entire industry, of which any corporation is likely to be but a small part. Also noteworthy are the occasional large fluctuations in quotations for foreign government bonds, utilities and industrials, owing to unsettled exchanges or to changes in public estimate of the solvency and good faith of the obligors.

If in practice it were possible for the investment trust to distinguish accurately the relative force of these two sets of factors affecting the quotations for its securities, a set of principles could be more readily established concerning the connection between market values at any time and the balance sheet entry opposite portfolio. As regards the first set of factors, little attention would need to be paid in the balance sheets to the long upward and downward swings in bourse quotations determined by money market or other extraneous tendencies, for the income of the trust would not in this case be appreciably affected, while the interest on its funded debt remains fixed.

**Profit from Depressed as Well as from Buoyant Markets.**  
—It is true that a period of monetary stringency might reduce



the market value of its holdings to a point far below their cost, and greatly weaken the trust's position if unforeseen circumstances compelled rapid realization on its investments. It is also true that these conditions would render more difficult any re-funding at this time of its bonded indebtedness, and increase the cost of further borrowing. For these and other reasons note should in any case be made in the auditor's report of the realization value at current prices of the trust's portfolio. Nevertheless the trust, if properly managed, will not be confronted with the necessity of sudden or unexpected liquidation of any considerable part of its portfolio and proceeds of any new borrowing could find relatively profitable investment in a market of depressed prices.

As it would be inadvisable to adjust downward the balance-sheet figures for investments under the conditions assumed above, so it would appear equally inadvisable to adjust them upward under the opposite circumstances of plentiful money and falling interest rates. In neither case is the income of the trust directly affected. Its capital position is relatively stronger when a buoyant market exists for its holdings; but in the final analysis an investment trust should benefit quite as much from periods of low security prices, when it buys at less than intrinsic worth, as from periods of high security prices, when it sells some of these holdings at more than their intrinsic worth. These are temporary conditions by which the trust should make considerable capital gains from year to year, by well planned purchases and sales, not only with reference to factors affecting values of all securities but also those affecting earning power of particular issues, and those influencing diversely the values of stocks (claims to participation in profits resulting from ownership of business) and bonds (claims to fixed annual payments on a capital sum).

**Tendency for Variations to Cancel Each Other.**—To the extent, on the other hand, that changes in market values ac-

curately reflect present and anticipated changes in earning power, there is better reason, in theory at least, for the investment trust to mark the balance-sheet figure up or down in accordance with current quotations for its investments. If it were possible to segregate the effects of this second set of factors, however, it would be found that in any investment trust enjoying wide diversification, the tendency would be for the fall in values of certain securities to be compensated by the rise in values of others. To the extent that increase in earning power were widely shared as the result of underlying business prosperity, stocks would tend to rise, while bonds might tend to fall. Moreover, random variations in values of stocks due to conditions in particular establishments, industries, or countries which they represent tend to cancel each other.

**Impracticability of Generalizations.**—These generalizations, while interesting from the viewpoint of investment trust theory, are of little practical significance in drawing up the balance sheet. Disentangling from the confused complex of market forces those factors which have been separately discussed in preceding paragraphs is a task for the economist rather than the administrator, and it is not feasible to go behind the selling price of the securities for purposes of refinement in presenting investment trust balance sheets. Capital gains and losses, if realized, enter the current income and profit and loss accounts, from which the net resulting changes are in due course carried over to the balance sheet. If not realized, but merely foreshadowed by valuations of the portfolio, these hypothetical capital gains or losses, as the case may be, need only be registered in the balance sheet, provided, on the strength of them, a stock bonus is distributed, or capital or reserves are cut to permit radical downward readjustment. In view of the fact that the audited income and profit and loss accounts of the trust disclose the changes in its current position far more readily than the balance sheet, any ordinary fluctuations in the value of

the investment trust's holdings should be mentioned in the auditors' notes but not necessarily carried to the general table.

In brief, balance-sheet figures for securities held by investment trusts should not be higher than actual cost, and need not necessarily be as low as current market quotations. The extent, if at all, to which they should be below actual cost in case of unusual depreciation, ordinarily depends, as will be seen in following paragraphs, upon the policies of reserve accumulation followed by the trust.

**Ordinary Accounting Practice.**—The following quotation, from R. H. Montgomery's "Auditing Theory and Practice" embodies the consensus of opinion among students of American finance, and briefly outlines the accounting methods required to give correct expression thereto. Several paragraphs are here reproduced in full, in order to permit an examination of the foregoing problem in the light of general accounting practice :

If the net result of the year's change in investments is a profit, it may be paid out in dividends; if the net result is a loss, it must be charged against surplus unless a reserve already exists against which the loss may be charged. The most conservative policy for the treatment of profits realized from changes in investments is not to credit them at all to the current income account, but to a special reserve or surplus account to provide for possible future losses on investments owned which cannot be foreseen at the present time. When profits on investments are treated as income, they should be shown separately in the income account.

Each individual investment need not be written down to market value when there has been a fall in price. If the aggregate market value of all investments equals the total cost thereof, that is sufficient. Should the aggregate market value, however, be less than cost, it is preferable to credit the net difference to a fluctuation reserve rather than to adjust the book value of each individual investment. It is also preferable to show the fluctuation reserve as a deduction ("in short") from the total value of the investments in the balance sheet, rather than as an item among the liabilities. This reserve is not an actual liability, but exists solely for the purpose of bringing the book value of investments down to market value. It is quite in

order to readjust the reserve from year to year to accord with changed market conditions. Care should be taken, however, that having treated reserves for losses or decreases in market values as an extraordinary charge in the profit and loss account of the year in which the reserves are made, that part of the reserves which is no longer needed when prices go up again, is not treated as ordinary income.

The book value of investments should not be increased when market prices exceed cost unless the surplus arising from reappraisal is clearly segregated from earned surplus. The excess should not be credited to the ordinary income or surplus account from which dividends are paid, but should be credited to a special reserve or surplus account, since conservative accounting practice is against increasing asset values above cost. On the other hand, there can be no deception if appreciation in values is clearly shown on the balance sheet. Stockholders are sometimes deceived when securities, which have greatly appreciated in value, are carried at cost.

Apparent increases in investment values by reason of rising market prices should not be treated as income until they have actually been realized by sale of the securities. It is important for the auditor to see that all profits on sales of investments which may be shown were actually realized, and that they have not been brought into the books by placing a higher value on securities received in making exchanges. So far as possible, the auditor should also satisfy himself that no part of the profit shown is the result of "wash sales" or other transactions of a similar character.

These concisely formulated principles are in general applicable to investment trusts, provided it is borne in mind that the most conservative practices suggested therein especially commend themselves to undertakings of this sort. To recapitulate, however, the question arises whether under any conditions an investment trust finding the "aggregate market value" of all its investments "less than cost" may fail "to credit the net difference to a fluctuation reserve" without departing from sound management policies. The answer to this question lies in the following considerations:

1. Whether in general the fall in market values is due to passing conditions whose effects may be reversed by the time of the next valuation, or is indicative of actual net decrease in earn-



ing power of investments or in security underlying the portfolio, due perhaps to insufficient diversification.

2. Whether the fall in market values would prove heavy enough to threaten a considerable impairment of capital, surplus or reserves if liquidation of the portfolio were imminent. If the depreciation is considerable, other things being equal, caution suggests balance sheet provision for it by "writing down" capital, reserves, or surplus, or in the manner suggested in the above quotation.

3. Whether it is the consistent policy of the trust to accumulate reserves by distributing considerably less than net income; and whether particularly the "profits realized from changes in investments" are customarily utilized as a contingent fund to "write down" cost of investments, or to enlarge the trust's "special reserve or surplus account to provide for possible future losses on investments owned, which cannot be foreseen at the present time."

**"Contingent Funds" of British Investment Trusts.**—If the balance-sheets of typical British investment trusts are studied<sup>1</sup> it will be seen that the figure for portfolio is commonly entered as "Investments at Cost or Under" or under some similar caption. The extent to which this figure is less than cost depends, however, not upon current valuation, if the latter is temporarily below cost, but upon the amount of the so-called "contingent fund" (really a concealed reserve) which is built up, year in and year out, mainly by the use of profits on turnover for this purpose. As British investment trust practice is uniform in this respect, and as there is much to be found, in the half-century of overseas experience in investment trust administration, to commend this practice to us, a brief description of it will be in place at this point.

**Employment of Profits on Turnover.**—The practice of crediting all realized gains on turnover to a "contingent fund,"

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<sup>1</sup> For a typical balance sheet, see Appendix D.



"inner" or concealed reserve, or "suspense account for adjusting value of securities," and of occasionally shunting to this fund as well a portion of the annual net income calculated on purely investment return, is one which has been followed with such marked success by the British investment trusts for several decades that the student will search in vain among the "profit and loss" or audited income accounts of the majority of them for any statement whatever of the amount of losses or of profits realized on changing investments. They refuse to assimilate the latter with other sources of income or to regard such profits as available for distribution in the form of dividends. These profits are in fact consistently reinvested.

The following is quoted from a memorandum recently submitted to the writer by a Scottish authority on investment trusts:

No trust company of any pretensions whatever does other than carry its profits on realizations to a contingent fund or to a reserve fund. The "contingent fund" here is a phase of accounting which is growing stronger every year with trust companies. There are several cases where the strength of the contingent fund is never made known and is indicated in the balance sheet only by the statement on the assets side as of "investments less contingent fund." This contingent fund is used for the debit and credit of losses and profits and in some cases is a fund of fairly considerable size. The tendency would be for young companies to adopt a similar process, and I believe this is being done.

In the articles of association of British trusts a provision to this effect frequently appears, but whether expressly stipulated or not this practice is always followed. This is in spite of the fact that the courts permit accretions of capital, when realized, to be brought into the profit and loss account and dealt with accordingly. The reason for the practice is primarily a desire to accumulate reserves or surplus which will steady the capital account and leave net investment income free for distri-

bution. The gist of the matter appears in this quotation from the 1922 annual meeting of the Merchants Trust:

CHAIRMAN: There was a change made recently in the accounts, following the practice of the other Trust Companies—those which we regard as the best. The difference of Profit and Loss sales of investments is now placed to a contingency account, the balance of which is deducted from "Investments at or under cost" as shown in the Balance Sheet. The difference was about £5,000.

MR. W. MITCHELL: Is that included in the Profit, sir?

THE CHAIRMAN: Oh, no. It is a Capital Reserve; it is placed to a contingency account. It performs the valuable function that if you make a loss you have a reserve, against which you can charge it. An Investment Trust Company, unless it had such a reserve, would have a figure in its Balance Sheet—"Loss on realizations"—which might affect the nerves of some people. I do not think it ought to, but a contingency account avoids that.

**Double Defense Lines.**—The British investment trusts therefore have two lines of defense, the reserves appearing in their balance sheets, equivalent to American reserves and surplus; and the "contingent funds," or "inner" and concealed reserves; the former are accumulated for the most part by re-investing a portion of the net investment income, and the latter are chiefly the result of reinvested gains on realization. When funds are used to increase the balance-sheet reserves, the cost of the investments acquired thereby enters the balance-sheet item for portfolio. When they are reinvested in the "contingent fund," the cost of securities so acquired does not enter the balance-sheet figure for portfolio "at cost or under." In this case, technically, the funds have been used "to write down the cost of investments" or to "write off depreciated securities." That is, although the company's holdings have been strengthened to that extent, the investments remain at the same figure in the balance sheet. This figure generally represents the actual cost of all investments held by the trust, minus the reinvested gains on turnover, or the "contingent fund"; and therefore, has no

relation whatever to current market value. When losses are realized from turnover, the proper adjustments are generally made in the "contingent fund," or a similar reserve.

**Contrasted Practices of Financing Companies.**—As contrasted with investment trusts, financing companies in the United Kingdom treat gains on realization as a source of revenue. They are lumped with interest and dividends in the current account out of which reserves are built and dividends paid. That being the case, allowance is frequently made in their profit and loss statements for current shrinkage in market values of securities, or vice versa. Whereas the directors of the typical investment trust, if they ascertain that the market valuation of their portfolio is somewhat less than the actual cost minus the concealed reserve, or contingent fund, content themselves with reference to this fact in the annual meeting record or the auditors' report (although dividends are often affected thereby), the financing company is expected to make allowance for these facts in its balance sheet and profit and loss accounts.

**Illustrations from Profit and Loss Accounts.**—The foregoing can best be shown by giving two or three typical profit and loss accounts. The first is for the British Empire Trust Company, a financing concern whose revenue is derived "mainly from the following sources: (a) interest and dividends from investments; (b) trusteeships, registrarships and secretaryships; (c) carrying on the business of an industrial bank, arranging the finance of industrial undertakings, underwriting and issuing new capital."

#### BRITISH EMPIRE TRUST COMPANY

##### PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED APRIL 30, 1922

Dr.			Cr.		
	£	s. d.		£	s. d.
To General Expenses, including investi- gations of new busi- ness and adminis-			By Trusteeships', Registrarships' and Secretaryships' fees. ....	15,782	0 6

Dr.	£	s. d.		£	Cr. s. d.
tration.....	17,442	17 5	By Interest and		
To Directors' Fees..	1,600	0 0	Dividends on In-		
To Audit Fees.....	525	19 0	vestments or Inter-		
To cost of removing			est on Loans.....	68,889	19 2
to and fitting up			By Adjustments of		
new offices.....	3,416	0 11	Reserve for Depre-		
To Income Tax Re-			ciation of Invest-		
serve.....	4,468	0 0	ments after valu-		
To Corporation Prof-			ing Investments		
its Tax Reserve...	1,822	0 0	now held at Low-		
To Balance, being			est Market Values		
profit for the year			at 30th April, 1922;		
ended 30th April,			Commissions		
1922, carried down	71,468	14 5	earned, etc. ....	16,071	12 1
	<u>£100,743</u>	<u>11 9</u>		<u>£100,743</u>	<u>11 9</u>

Industrial conditions not being then favorable, the earnings of the British Empire Trust Company for 1921-22 were mainly from fees, and interest on loans and investments. The third item on the credit side shows that the company considers itself obligated to maintain the capital account on the one part, but free to regard surplus reserve as current revenue on the other.

The next profit and loss account is for a typical smaller financing company:

#### NATIONAL AND FOREIGN SECURITIES TRUST, LIMITED

##### PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST AUGUST, 1921

Dr.	£	s. d.		£	Cr. s. d.
To General Expenses, in-			By Dividends and In-		
cluding Office Rent,			terest,		
Directors' Fees, Secre-			Profit on Sales of		
tary's Salary, Audit			Shares, etc. ....	8,037	12 8
and Sundry Charges .	1,958	5 8	By Registration Fees..	1	17 0
To Discount on Deben-					
ture Stock Issue. ....	300	0 0			
To Balance carried down	5,781	4 0			
	<u>£8,039</u>	<u>9 8</u>		<u>£8,039</u>	<u>9 8</u>

The last revenue account to be cited is that of a typical investment trust:





pense Account" reveals the gains and losses on turnover for the year in question:

STATEMENT OF ACCOUNTS OF THE GAS, WATER AND GENERAL  
INVESTMENT TRUST, LTD.

FOR THE YEAR ENDED 28TH JANUARY, 1925

Suspense Account for Adjusting the Value of Securities, Etc.

Dr.	£	s.	d.		£	s.	d.	Cr.
To Balance from last Account.....	448,424	17	2	By Profit on Securities Realized.....	1,379	10	4	
To Realized Losses on Investments...	9,763	7	6	By Balance carried to next Account, being Losses realized and Amounts written off cost of Securities to date.	456,808	14	4	
	<u>£458,188</u>	<u>4</u>	<u>8</u>		<u>£458,188</u>	<u>4</u>	<u>8</u>	

Revenue Account

Dr.	£	s.	d.		£	s.	d.	Cr.
To Interest on 4% First Debenture Stock.....	10,000	0	0	By Dividends and Interest on Sundry Investments.....	20,942	5	6	
To Interest on Loan and Deposit.....	862	10	2	By Commission.....	245	0	0	
To Directors' Fees, Office Rent and Salaries.....	1,750	0	0	By Transfer Fees.....	17	3	0	
To Audit Fee.....	73	10	0					
To Charges Account.	132	16	1					
To Income Tax.....	119	18	3					
To Corporation Profits Tax to 28th January, 1924.....	7	16	0					
To Balance, being Profit carried to Balance Sheet to the Credit of "B" Debenture Stockholders.....	8,257	18	0					
	<u>£21,204</u>	<u>8</u>	<u>6</u>		<u>£21,204</u>	<u>8</u>	<u>6</u>	

Recapitulation—Factors of Safety in Investment Valuations.—In the long run, any well-managed trust which thus

reinvests at compound interest all of its realized gains on turnover (and perhaps a fraction of its net earnings calculated from its ordinary and continuing sources of income) will generally find the periodic revaluation of its investments considerably in excess of its capital liabilities. American investment trust practice has not as yet been clearly established in this regard, although the investment trusts organized in this country to date reserve the right to distribute profits realized on turnover and regard such profits as a part of current income. The extent to which the estimated market value of portfolio exceeds the combined liabilities represented by capital, surplus and balance-sheet reserves depends in considerable measure, of course, upon the success of the investment trust in accumulating a large contingent fund, or concealed reserve.

Stock exchange values may tumble until this concealed reserve is more than used up, but no note need necessarily be taken of it in the balance sheet. In such a case the balance sheet reserve and surplus are a further element of safety protecting the common shareholders. On the other hand, if values are buoyant, the trust may transfer from its concealed to its balance sheet reserve; or in other words, add to the "reserve" figure on the liabilities side and correspondingly mark up its "investments" total on the assets side. Further appreciation in its securities may even lead to the distribution of bonus stock by the trust, and to the corresponding reduction of its "reserve" and addition to its "issued capital." It is in this way that profits on realization are in a sense occasionally "distributed." As the dividend rate is usually in such cases adjusted to the greater volume of outstanding stock, the recipient of the bonus shares gains little advantage, except from the higher selling price of his larger holding, unless a more liberal policy in distributing net income is adopted at the same time.

In any case the consistent application of the more conservative practices frees the investment trust from any obligation to keep its balance-sheet entries for investments in strict accord

with current valuations, or to make periodical allowance in its accounts for current shrinkage in investment values; while on the other hand it immeasurably fortifies the position of the trust's owners and creditors, and by gradually increasing the dependable net income, contributes to steady progress in raising the dividend rate.

### **Current Valuation of Investments in Auditors' Reports.**

—From this it must not be surmised, however, that the investment trust is justified in withholding the results of its periodic revaluations from its owners, its creditors, or even from the general public. If the Scylla of tying a stable revenue producing portfolio to the changing valuations of the market must be avoided, so must also the Charybdis of misrepresenting the true position of the trust at any time by neglecting such considerations as the current liquidation value of its holdings.

The *London Economist* comments thus in its issue of March 22, 1924, upon the failure of British investment trusts to reveal the true current position of their capital account, and the disconcerting lack of uniformity in methods of reporting their portfolio figures:

Of course, it may be pointed out that the current value of these securities is not of paramount importance, that as long as the return from fixed interest securities remains unchanged, investors have little or no need to worry about changes in capital values. But we do not think that the implication here is sufficient for obscuring the true position of an undertaking.

The following is quoted from the Chairman's remarks in the annual meeting of the Investment Trust Corporation, Limited, at London, June 4, 1924:

Dividing the subject, as we have often done, into two parts—namely, capital values and revenue results—I would say with regard to capital account, that, as the report shows, the market value of the company's assets is some 2 per cent more than a year ago. The exact method of valuation, as I have more than once mentioned, is, with regard to the great bulk of our securities, namely, those having

a quotation in the official lists of London, New York, or other well-known stock exchange, to take the middle price, which, if you count stamp duty, brokerage, and jobber's turn, is considerably less than we would have to pay to effect a purchase in the market. Of our total number of securities—namely, 419—there are 399 so quoted, leaving 20 stocks and bonds of a total market value of £195,887 not officially quoted. Some of these, though not listed, are fairly saleable; for some we have obtained from brokers what they deemed fair quotations; a very few the directors have valued at what they consider safe prices. Altogether you may count on £5,280,000 as being the fair value of our investments. Not that we could in a day sell £5,000,000 worth of stocks and bonds at close market prices, any more than we could buy them at these quotations. That sum of £5,280,000 shows a value in excess of 7 per cent over the book cost. The report shows the different classes of security in which the funds are invested.

The following quotation is from the Chairman's remarks in the annual meeting of the Alliance Trust Company, Limited, at Dundee, April 17, 1925.

I observe that the chairmen of other trust companies have been expressing somewhat divergent views on this subject of capital valuation. One authority indicated that depreciation of investments was of no importance to a trust company, as its stockholders were only interested in the amount they might receive in dividend. The chairman of another company expressed his emphatic dissent from this line of thought, and his agreement with the dictum "take care of the capital and the revenue will take care of itself." Now, there is no doubt that the chief object of an investment trust is the provision of a stable and increasing revenue, but the intimate connection between this and a sound valuation is surely obvious. If on making up our accounts for the year we were to find that our revenue comes out at a satisfactory figure, but that a valuation of the bonds and stocks from which it is derived shows that their prices stand at an unsatisfactory level relatively to the conditions of the time, and that the percentage of the revenue to the valuation figure is therefore unduly high, we should rightly find in that a danger signal, and an indication that our revenue, if high, was unstable. An intelligent stockholder, therefore, must always be interested in the question of the annual valuation as well as in that of the annual revenue. Indeed, every stockholder may find his interest become immediate and

acute, because a prudent management faced with undue depreciation will at once turn its attention to remedying this by making contributions from revenue towards the writing down of the securities affected. It is also difficult to see how an actively managed investment trust company can, in any event, fail to be interested in the prices obtainable for the securities which it buys. From every point of view, therefore, we are glad to report to you that our satisfactory revenue figures are buttressed by a sound capital valuation.

**Methods of Valuation.**—In any case it is essential for the guidance of the directors that at least annual valuations be made. The difficulties of such valuations are generally less with investment trusts than financing companies, by reason of the greater proportion of the former's securities which are listed on the exchanges. The United States Debenture Corporation, Ltd., for instance, reports 94% of its securities regularly quoted on the exchanges, while the Anglo-American Debenture Corporation reports that "of our investments 94% are publicly quoted, and only a small proportion of 6% are unquoted." With publicly quoted securities, the valuation is generally taken at the midpoint of the day; for the unquoted securities a conservative estimate of realization value is usually made by or for the directors. Valuations thus arrived at for the entire portfolio should be given in the auditors' reports. The tendency in the United States being toward greater publicity in the relationship of industries to the stockholders and the general public, it would seem wise for investment trusts to publish certain main facts concerning their holdings, if not all the details. The public interested in investment trusts should be sufficiently instructed to take these valuations for what they are worth, for by withholding them the dangers are incurred of loss of public confidence, or of temptation to carelessness in the management policies of investment purchase and turnover.

With these safeguards the policy, described in the paragraphs quoted above from Montgomery's book, of maintaining a "fluctuation reserve . . . as a deduction (in short) from the



total value of investments in the balance sheet," while highly commendable, does not seem always essential to sound management under the conditions cited above, and for reasons already detailed. Nevertheless, even if this method of allowing for fluctuating values has been consistently followed it is not advisable for an investment trust to increase book value of investments "when market prices exceed cost" despite the fact that the "surplus arising from reappraisal" may be "clearly segregated from earned surplus," except, perhaps, in a very exceptional case in which it may be advisable to issue a stock bonus without utilizing ordinary or concealed reserves for the purpose. If invisible or concealed reserves are so used, or are converted into ordinary reserves, the investments would of course be marked up above their previous book value, but not above their market cost. If on the other hand merely the enhanced earning power of the securities were being capitalized, the book value or balance sheet entry for investments would be marked up beyond the cost of acquisition.

## CHAPTER VIII

### ACCOUNTING PROBLEMS (CONTINUED)

**Payment of Dividends while Capital Is Impaired.**—The problems discussed in the preceding chapter suggest a further related question. Should dividends be paid by an investment trust while its capital is impaired? Is it advisable for an investment trust to declare earnings on its common stock irrespective of the current valuation of its investments, especially if such valuation discloses a realization figure less than the trust's capital liabilities?

There are comparatively few exceptions to the general principle that dividends should not be paid when capital is impaired or when such payment would impair capital. State laws are less specific on this matter than the standards of modern accounting. Corporation laws of some American commonwealths state that a loss of previous periods need not be considered; of others, that dividends should be paid purely from surplus; and the statutes of a few states are silent.

An amendment to the New York State laws, effective October 1, 1923, was evidently designed to maintain the integrity of the original contributions of capital:

Any or all of the shares of any stock corporation, other than a moneyed corporation, may be issued without par value, provided there be included in its certificate of incorporation the following statements:

1. The total number of shares that may be issued by the corporation.
2. The number of shares, if any, which are to have a par value and the par value of each.
3. The number of shares which are to be without par value, and
  - A. The capital of the corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value,

plus ..... dollars (the blank spaces being filled in with some number representing one dollar or more) in respect to every issued share without par value, plus such amounts as, from time to time, by resolutions of the board of directors, may be transferred thereto; or

B. The capital of the corporation shall be at least equal to the sum of the aggregate par value of all issued shares having par value, plus the aggregate amount of consideration received by the corporation for the issuance of shares without par value, plus such amounts as, from time to time, by resolution of the board of directors, may be transferred thereto.

Provision is made for transfers from surplus arising from stock dividends. In other respects the law, as amended, does not depart materially from the previous law—as to the discretionary powers of the directors and stockholders relative to the values to be placed upon the consideration for which the shares may be issued.

The attitude of American courts, lawmakers and accountants is thus fairly summarized in Sullivan's "Pennsylvania Business Law":

The directors of a corporation should not pay a dividend to stockholders while the corporate capital is impaired. This is a fund which the creditors and others interested in the concern have a right to expect will be kept intact, as far as the uncertainties of business will allow. Even when capital is unimpaired, the directors have discretionary power to determine not only the amount of all dividends, including dividends on preferred stock, but also the circumstances under which they may declare them.

What may be sanctioned as sound practice for investment trusts in the different situations which may conceivably arise for this type of undertaking is, of course, a matter for the courts to decide when sufficient numbers of investment trusts have been operating in the United States to bring grist to our legal mills.

**Exceptional Status of British Investment Trusts—The Verner Case.**—In this connection, however, it is interesting and significant to discuss in some detail the exceptional position

long enjoyed by investment trusts in the United Kingdom, as for more than a quarter century it has there been recognized that an investment trust may pay dividends, even though the value of its investments is dwindling.

The sanction for this is found in what are known as the *Lee v. Neuchatel* series of decisions of the earlier Court of Appeal (Supreme Court of Judicature). These decisions are *Lee v. Neuchatel Co.*, 41 C. D. 1; *Verner v. General Commercial Trust* (1894) 2 Ch. 268; and *Wilmer v. Macnamara*, (1895) a Ch. 245. These cases all deal with dividends payable at a time of depreciating capital, and interpret the requirements of the Companies Acts with respect to distributable revenue. Although somewhat discredited in the tone of later decisions, they have never been definitely reversed in appeal to the House of Lords. Their significance for investment trusts is most clearly seen in the *Verner* Case, in which the defendant is a trust company. The principles enunciated were not intended purely for investment trusts, however. The *Verner v. General Commercial Trust* ("General and Commercial Investment Trust Ltd.") case arose from the friendly action of a stockholder who wished to ascertain whether an investment trust could continue to pay dividends when the investments in which its share capital was sunk showed depreciation below the par value of the stock. The Lord Justices affirmed an earlier decision that dividends could be paid out of returns from a trust's investments even though the capital account showed impairment. This case was of the greatest importance at a time when securities were so heavily depreciated, and permitted many companies whose investments were intrinsically sound to keep up a steadier rate of dividend.

The legal subtleties upon which this decision was based are not easy to follow. In stating the above doctrine the Lord Justices were equally emphatic that dividends must not be paid out of borrowed money, or "capital." "Capital" they define

as the funds put into the company by the preferred and ordinary stockholders:

The broad question raised . . . is whether a limited company which has lost part of its capital can lawfully declare or pay a dividend without first making good the capital which has been lost? I have no doubt it can; that is to say, there is no law which prevents it in all cases and under all circumstances. . . . But the provisions as to capital when carefully studied are wholly inconsistent with the return of capital to the shareholders whether in the shape of dividends or otherwise, except of course on a winding-up. . . . The main condition of limited liability is that the capital of a limited company shall be applied for the purposes for which the company is formed, and that to return the capital of the shareholders either in the shape of dividend or otherwise is not such a purpose as the Legislature contemplated.

But there is a vast difference between paying dividends out of capital and paying dividends out of other money belonging to the company and which is not part of the capital mentioned in the company's Memorandum of Association. . . . The capital of a company is intended for use in some trade or business and is necessarily exposed to risk of loss. . . . If, therefore, the company has any assets which are not its capital within the meaning of the Companies Acts there is no law which prohibits the division of such assets amongst the shareholders.

A further distinction reaches the heart of the matter for the investment trusts. Dividends must be paid out of "profits." Profits mean an excess of income in the ordinary course of a company's business over the outlay required for such income. A company's "circulating capital"<sup>1</sup> is continually being used up in its daily profit-getting, and unless it is fully maintained there are no "profits." Therefore, although loss or depreciation of "fixed" capital need not affect the profits, loss or depreciation of "circulating" capital must be taken into account.

The ridiculous distinctions to which such a doctrine, if rigidly applied, might lead may be illustrated in the case of a

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<sup>1</sup> Circulating capital in this sense has been defined by Palmer (*ibid.*) p. 221, as—"Capital which performs its whole office in the production in which it is engaged by a single use, *e. g.*, the goods which the merchant has for sale, . . . the horses of a horse dealer, etc."



mine, which has been purchased by shareholders' money. In taking out coal its veins are being rapidly exhausted, but no depreciation fund need be maintained. Dividends cannot be distributed, however, without full allowance for fuel used up in drilling, tools worn out by use, etc. It is a question whether we would class engines, tracks, etc., in this case as "fixed" or "circulating" capital. British companies, it might be added, generally ascertain their profits by strict business methods and do not take advantage of the power which these decisions would seem to give them to "inflate profits at the expense of capital."

Now the Court finds that the articles of association of the investment trust "are so framed as to authorize the sinking of capital in . . . stocks, funds, securities and the payment of dividends out of whatever interest, dividends or other income such stock, funds and securities yield. . . ." It is not a company "formed for the purpose of buying stocks, shares and the like to sell again"; and its business is not primarily "to make profits on such resale." The investment trusts, according to the opinion of Lord Justice Kay in the Verner case, "buy stock shares and the like, and they have power to sell and change them. But they buy as investments and do not look to the sale as the source of their profit." In the above is found a clear separation of the investment trust and the financing company. The investments held by the former are virtually its "fixed capital." The investments held by the latter are its "circulating" capital. In fixing its dividend the investment trust is not compelled to allow for depreciation in the value of its holdings; but in calculating its profits the financing company, like any ordinary trader, should take a yearly account of all the capital employed in its business, allow for loss or depreciation, and carry the balance to profit and loss. Upon examining the balance sheets and profit and loss accounts of financing companies it will be seen that there is an annual valuation of investments and other properties, that this valuation generally

appears in the published balance sheets if it is less than cost, and that, as a rule, dividends are only paid when capital is intact.

To recapitulate, the Verner case decided in effect that, subject to the articles of association, the net excess of current income over current expenditures of investment trusts may be distributed before depreciation in investments is made good; that, in contrast with financing and security trading companies, the investment trust might regard its holdings of securities as partaking of the character of fixed assets; and that, though sufficient assets must be retained to meet all ordinary liabilities, depreciation on fixed, or wasting, assets need not be made good before the payment of a dividend. This the Court maintained was good law, whether or not it was good economics!

The economic principle underlying these earlier decisions was probably the fact that an investment trust, unlike a bank, an insurance company or a trading, financing and promoting company, is not subject to irregular or uncertain demands. It can anticipate the time when its borrowings must be refunded, and it is certain of solvency as long as dividends and interest accrue from its holdings. In fact, the value of investments and the income derived from them often diverge, as earnings depend upon the year's trading profits and stock exchange quotations look to the future.

#### **Generally Accepted Principles Not to Be Departed From.**

—Examination of the problem from a broad point of view will show the exceptional position occupied by the investment trust. Theoretically, the same considerations set forth above as justifying under given circumstances the exclusion from the balance sheet proper of current valuations of investments, would also seem to justify the uninterrupted payment of dividends at a time when the portfolio shows appreciable decline in market value. A well-managed investment trust is not required to liquidate at a period of falling security values; this is rather the time when it should take advantage of unusual buying oppor-

tunities. Again it may be remarked that unless the decline is due to a falling-off in earning power, or to an undermining of safety (factors not likely greatly to upset the calculations of a trust enjoying sufficiently wide diversification of risk), there is no urgent need of allowing this decline to affect the current dividend unless it is one of very substantial proportions. Even during the long period of drastically falling prices on the London Exchange in 1920 and 1921, the dividend rates of the majority of British investment trusts, including those whose capital seemed to be greatly impaired, maintained a surprisingly steady level.

Nevertheless, if an investment trust desires to maintain an even or rising dividend rate regardless of any random or cyclical fluctuations in the computed values of its portfolio, it is advisable, if not essential, that the conservative practices be followed which are outlined in the preceding chapter. Reserves should be consistently accumulated by utilizing profits on realizations, and by allocating regularly a liberal proportion of net income to this purpose. Thus any theoretical considerations which might justify an ignoring of current valuation in determining dividend rates are fortified by a building up of reserve strength which will insure that even a considerable impairment in current realization value of portfolio will not go below the margin protecting capital. If such policies are not followed it is advisable for directors to consider very carefully from year to year the status of the capital account, and to make, if possible, full allowance for currently maintaining capital, as need arises, by deductions from net revenue taking precedence of dividends.

The following is quoted from a memorandum on the accounting policies of American investment trusts prepared by Nathaniel Bergman, of the taxation division of Lybrand, Ross Bros. and Montgomery:

It must be admitted that there can be found very plausible reasons for the payment of dividends by investment trusts even though

the capital has been impaired. It can be reasoned that in effect the shareholder is making a personal investment in various securities, and it is superfluous to state that the individual investor regards all bond interest and cash dividends as income. Possibly the only exception to this is where a prudent investor has purchased a bond at a premium and decides to amortize such premium by setting aside a portion of his interest as a return of capital. . . .

But it is doubtful whether the American investor will invest readily in any security which does not provide adequate safeguards against the loss of his capital. If the above analogy is a good one, the logical answer is that the individual investor's direct investment in, say, a manufacturing plant is maintained by adequate reserves for depreciation, obsolescence, etc. The investments by the investment trust are the plant, and should be maintained intact.

**Conservative Practices of British Investment Trusts.**—Although the distinctions introduced by the Verner case were considered of fundamental importance in the early development of British investment trusts, and were in part responsible for the conversion of several financing companies into investment trusts after the Baring crash and the troubles of the early Nineties, it is to the credit of British trusts that they do not as a rule take advantage of their favored position in these respects. As a matter of practice, they maintain liberal reserves, voluntarily appropriate from current income or reserves to write off marked depreciation in their portfolios, and when the depreciation is due to other than temporary causes, even reduce or pass the dividend on their common shares. They thus tend to conform to accepted practice—a policy which particularly commends itself in the United States, at least until longer experience with investment trusts in this country has demonstrated in what ways, if any, they may be safely set apart from other undertakings.

**Crediting Accrued Interest and Dividends.**—There is one respect in which British investment trust practice is more conservative than would seem necessary or advisable in the United States. This is in the failure to take credit, in their



balance sheets, for accrued interest, even though such income is more than reasonably certain. For instance, the Chairman of the Anglo-American Debenture Corporation in the 1925 annual meeting, (May 16) announced that:

Ever since the formation of this corporation it has been our custom to accrue the interest on investments, and although for some years the revenue account has shown practically the amount of cash received owing to the fact that the amount accrued has not varied much from year to year, we felt that the time had arrived when it would be well to bring our accounts into line with the great majority of investment trust companies, who prepare their revenue accounts, so far as the receipts are concerned, on a purely cash basis. This explains the deduction of £15,111, which you will notice has been made from the balance brought forward from last year.

This practice of not accruing interest has been explained in an article by Edward Maitland Campbell,<sup>2</sup> and there seems no reason to add any comments to the latter's exposition:

Another direction, in which conservative treatment of revenue has been found prudent, is in regard to accrued income. From an accounting point of view, it is quite permissible to take credit in the balance sheet for interest and dividends accrued to date, though not yet paid, but this practice is apt to cause difficulties. When a security which has been paying interest suddenly defaults, the company not only has to forego the interest on the security for the year of default, but it has also to write off the interest, for which credit was taken in the accrued income account at the end of the previous year, and thus a double burden is thrown upon the revenue account of one year. On the other hand, when a company is first started, the revenue can be treated purely on a cash basis and taken credit for only after it has actually been received. This plan avoids altogether the necessity for having an accrued income account on the assets side of the balance sheet, though it reduces the first year's revenue receipts. If, however, a company has once begun to take credit for accrued income, the account can be eliminated only by appropriations from revenue. When this has been accomplished by appropriations from revenue over a series of years, the company has

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<sup>2</sup> "Some Management Problems of Investment Trusts," *Harvard Business Review*, April, 1924.



then an additional reserve fund of considerable size. Thus, for example, if interest were payable half-yearly on all the investments and all the amounts falling due monthly were exactly equal, the accrued income at any one date would be a quarter of the full year's revenue of the company. If no credit were taken for this in the balance sheet, it would be equivalent to an "invisible" reserve fund, for on liquidating the company this amount of income would fail to be received. British investment trust companies have tried both methods of treating accrued income, and it is safe to say that the conservative plan, of taking no credit for this item, is now recognized as the wiser course.

**Questions of Taxation.**—One very interesting distinction between investment trusts and financing companies in Great Britain, which is not likely to arise in the United States, is found in the fact that the Inland Revenue Authorities of the United Kingdom permit investment trusts to deduct profits on turnover from their taxable income, whereas financing companies must pay on their entire revenue, inclusive of such profits. This exceptional treatment arises from the universal practice of reinvesting gains on capital account and this is undoubtedly one consideration favoring the continuation of this practice. In the 1925 annual meeting of the London Prudential Investment Trust the chairman stated:

Were we to treat as available for purpose of paying dividends the amount that we have placed to reserve account, we should automatically deprive ourselves of advantages enjoyed by investment trust companies in matter of taxation, and would become liable to pay income tax on that amount.

The Scottish authorities, until recently, however, differed in their application of the same Income, and Corporation Profits taxes. In this respect the Scottish practice was akin to the American in that capital accretions were taxed as income. Differences of opinion existed among investment trust executives of Scotland and England as to the advantages of each system. The English exemption was sponsored by the trusts at a time when values were rising and profits on sales con-

siderable. As capital losses cannot be deducted from taxable income if capital profits are exempt, the taxes payable by English companies were greater than they otherwise would have been during the recent years when securities were heavily depreciated, and foreign holdings were often sold at a loss to aid war finance.

The Scottish trusts were, of course, permitted to deduct losses, and have derived advantage therefrom during and since the war. Losses must be realized to be deducted, and some companies north of the Tweed have been known to sell depreciated securities before making up their returns, and to buy them back shortly after. Permission was given to Scottish investment trusts in the year 1923-1924 to adopt the same standards as the English trusts in income tax reporting. A large majority of the older Scottish trusts, and all the new British investment trusts are now operating on this uniform basis of taxation.

It was a common pre-war practice for British trusts to issue debentures and preference shares with a tax-free covenant. At the time of such issue a rate of only one shilling or so on the pound was contemplated. Although the income tax rose to six shillings and has but lately fallen to four, the interest and stipulated dividends on securities sold under these covenants have not been changed. A Scottish trust executive in referring to this, has recently complained to the writer of the different treatment accorded them on the American "tax-free" bonds in their portfolio.

The domestic charge bearing most heavily upon British trusts was the corporation profits tax before its recent repeal. The burden of the latter, with the income tax on such part of the net revenue as was put into reserve, fell upon them, and made their accumulation of reserves a slower process than theretofore. Investment trusts sought to escape this levy on limited companies by arguing that they were merely "conduits for capital." It was then decided that they need not pay the tax

on dividends from companies already subject to it. It happens that railways and public utilities had been exempted for a number of years, and as trusts held heavy interests in these and government bonds, the corporation profits tax became a real burden.

**International Double Taxation a Serious Problem.**—In fact international double taxation is a factor of the greatest importance to British investment trusts in the shifting of their investments from the United States to other countries, or to domestic issues (see pages 197 to 200). On numerous occasions British investment trust secretaries have complained to the writer of the uncertainties, delays, and apparent working at cross purposes of American income tax administration. It is stated that when assessments are on appeal, letters are received threatening seizure in lieu of immediate payment, and that final adjustments are not yet made for all earlier post-war years. There is more dissatisfaction with what is termed a cumbersome machinery than with the rates themselves. Domestic investments are not subject to double taxation; and the degree of reciprocity worked out with the Dominions in income tax matters is an incentive to invest there. Were the United States a borrowing country, serious attention would have to be given to removing artificial obstacles of this kind, in order that our industries might compete for foreign capital on equal terms with those in countries of lower income tax rates, or simpler procedure. Investment trusts organized in the United States will have to face this problem in their foreign investments, particularly in those countries where well-administered and burdensome income taxes prevail.

**Preparing Reports for Stock and Certificate Holders.**—Among those American investment trusts which are not directly subject to the Federal income tax, there arises the accounting problem of instructing their stock or certificate holders

as to the amount of tax they are liable to pay on their pro rata share of the investment revenue and capital gains.

The Bond Investment Trust, for instance, a Massachusetts common law trust not classified as an "association" for Federal taxing purposes<sup>3</sup> announces that:

The Massachusetts Income Tax on the investments of the Trust is paid by the Trust. The 5% income paid to certificate holders, who are residents of Massachusetts, is to them exempt from this tax.

The Federal Income Tax on the investments of the Trust is not paid by the Trust. Each certificate holder is advised shortly after January 1st each year as to the part of the income on which a Federal Income Tax is to be paid by the holder.

The Investment Managers Company announces on behalf of the holders of its investment trust certificates (certificates of beneficiary interest in the investment fund deposited with a trustee and managed by the company) that:

The position of each Certificate Holder as to Federal Income Taxes now in force, is substantially identical with what his position would be if he held directly his proportionate part of the Investment Fund.

An audit of the Investment Fund by a Certified Public Accountant of recognized standing will be made as of December 31st in each year and a report approved by the Auditor will be mailed to each Certificate Holder within sixty days thereafter showing in detail the securities held in the Investment Fund on that date and the sources of all income realized during the preceding twelve months.

This report will also furnish each Certificate Holder with a statement of his proportionate share in such income from each source, in form to be used in his Federal Income Tax return. So far as may be practicable, it will show the amount of income derived from the Investment Fund which may be exempt from Federal taxation, the amount which may be exempt from taxation at the normal rate, the amount which may be reported as "Capital Gain" and the balance subject to taxation.

All income derived from dividends on stocks held in the Investment Fund will be exempt from present Normal Federal Income Tax.

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<sup>3</sup> See Chapter II.

**Accuracy and Detail in Accounting Records.**<sup>4</sup>—The importance of maintaining adequate accounting records is especially to be noted in the case of investment trusts, whose trustees, or directors, bear in fact, if not always legally, a fiduciary relationship towards share and bond holders. The direction should, therefore, err rather on the side of abundance than paucity of records, and unless sound reasons exist for the contrary, a liberal attitude should be taken toward publicity.

Particular importance attaches to the record of purchases and sales of investments. The proof of such purchases and sales should be filed in such a manner as to permit of verification of additions to and withdrawals from the investments. In the case of bonds, mortgages, or notes, the record should always disclose clearly that portion of the purchase or sale price, if any, which really represents accrued interest. With respect to the purchase or sale of stocks a clear record should likewise be made as to whether the stocks are acquired or sold ex-dividend, this being fully as important in the case of standard securities as the differentiation between the principal on purchase of bonds and the amount paid for interest accrued thereon. A complete and up-to-date record should be available at any time of the totality of transactions in any holding, profits and gains being segregated to their several accounts, in order that the average cost of any investment may be readily ascertained. The importance of keeping a thorough record of purchases and sales of securities has been emphasized by the various state and federal tax laws, which have prescribed the basis of arriving at the profits or losses on sales of securities.

The records should be very clear as to the amount of dividends and interest collected, or accrued, within the fiscal period; so also with stock dividends received. Although stock dividends are not considered income by the Federal taxing authorities, their status in connection with accounting for com-

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<sup>4</sup> The concluding paragraphs of this chapter have been closely adapted from a report prepared for the writer by Nathaniel Bergman, of the taxation division of Lybrand, Ross Bros. and Montgomery.



mon law trusts has a peculiar significance. In arriving at true income a question may arise as to what part of a stock dividend should be credited to income and what proportion should be considered as being applicable to capital.

The journal should record very explicitly any adjustments made affecting the company's financial position. If on occasion it should be considered advisable to make adjustments in the investment account with respect to any investment, as, for example, when the condition of a certain corporation warrants radical readjustment in the book values at which its securities were being carried, this fact should be set forth in such a way as to avoid any possible criticism.

In closing the books at the end of any fiscal period, care should be taken that all accrued interest, and dividends which have been declared, are taken into account. An exception to this might be made on those cases where the condition of the companies indicates that such dividends or interest may not be paid.

The various books to be kept will suggest themselves as the peculiar ramifications of the business are studied. There are certain records, however, which should be kept, and any detailed records may be built up around these fundamental ones. In the last analysis, the extent to which the records shall be maintained and safeguards introduced will be governed very largely by the indenture, articles, or by-laws. Capable and well-intentioned directors will assure themselves of sufficient completeness to permit certification by public accountants of the company's financial position at any particular date, and a check of the transactions between fiscal periods.

## CHAPTER IX

### EARNINGS OF INVESTMENT TRUSTS

**Sources of Income.**—The typical British investment trust derives its revenue from the following sources :

1. The return on its interest and dividend bearing securities
2. Fees for trustee, secretarial and registration services
3. Underwriting fees

As noted in the last chapter, "profits on change of investments," or "gains on turnover" are not regarded by British investment trusts as ordinary revenue, but are placed in the contingent funds. Nevertheless, these realized gains on appreciation are often substantial, and they are enjoyed at one time or another by every British trust.

Among American investment trusts, organized to this time, the straight investment yield, and the profits on turnover are the only regular sources of income, as underwriting has not yet been attempted, and the duties under (2) are handled by other long-established agencies.

**Investment Income.**—This is by far the most important source of revenue for the investment trust. It is, moreover, owing to diversification in holdings and the predominance of prior lien securities in the portfolio, a very dependable one. In addition to the capital obtained by sale of preferred and common stock and bonds, many investment trusts, especially in Scotland, now secure funds cheaply on short-term loans and time deposits, and utilize this additional capital in purchasing shorter dated maturities (see pages 56 to 58). Furthermore, investment trusts can afford to employ profitably in this way the current income from their investments until the dividend

dates, as the periodical and dependable nature of their payments permits reduction of their liquid assets to an insignificant ratio.

**Caution Required in International Comparisons.**—In comparing the earnings on invested capital of British and American companies, caution should always be observed because of the fact that the former report only the investment yield (see pages 132 to 137), whereas the practice of the latter is not as yet differentiated from that of any financing company which includes gains on turnover in its revenue accounts. It is singularly unfortunate for the student that English and Scottish trusts do not ordinarily report their “profits on change of investments,” especially as this item is likely to be of considerable importance in well-managed American trusts (see Chapters VI, XV and XVI).

A further circumstance of importance in comparing investment yield on the holdings of British and American trusts is the general practice obtaining among the former of stating revenue, after deduction of income tax. Until uniformity is secured in methods of reporting income, and unless the comparative burden of such taxes is taken into careful consideration, the income tax factor alone is likely to vitiate attempts at parallel studies of this kind.

**Investment Yields.**—A study of the earnings and dividend exhibits of leading Scottish and English trusts given in Appendix G reveals an average investment yield<sup>1</sup> on the portfolios of 6.21% in 1923-1924 and 6.30% in 1924-1925 for twenty-one leading Scottish companies, and of 5.66% and 6.03% during the same two years for twenty-three representative London companies. American trusts are of too recent origin and too varied type to permit compilations of this sort

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<sup>1</sup> That is, gross revenue, less income tax. In the gross revenue item there are included other earnings classified in (2) and (3) above, but the latter are so small as compared with the pure investment return that their inclusion does not materially affect the percentages on capital.

and the reader is referred to Chapters XV and XVI for detailed treatment.

If these figures cited for investment trusts in the United Kingdom seem small, as compared with the investment yield which an American company might reasonably expect on a well diversified portfolio, it should be borne in mind that especially since 1914 the capital of British trusts has gone in larger ratio into domestic and government issues; that the rates of interest prevailing in Great Britain are still less on the average than in the United States; that the large amount of capital borrowed perpetually or for long periods, at 4% or thereabouts (see pages 49 to 53) has made possible liberal earnings for common shareholders despite an average investment yield of 6% or less; and that the yield is substantially reduced by an income tax of four shillings in the pound.

**Miscellaneous Sources of Income.**—British trusts often act as trustees for debenture holders of other companies, and render miscellaneous services classed under trust company activities in America. It is not customary, however, for them to accept trusteeships for private estates. From underwriting fees and charges for services of the former type investment trusts in London and Edinburgh occasionally meet all their office and general expenses. Unless underwriting profits are realized, they are not written into distributable income. For instance, if a company is required to take up a part of its quota, or if it chooses to enter a public subscription, the price which it pays is, of course, less than the public offer by the amount of the underwriting margin. In this case, however, the book profit is not credited to current income; but when the securities are sold again, the net profit (if there is any) is treated in the same way as all profits on realizations.

**Management Expenses.**—In considering the expenses of investment trusts we are again compelled to rely mainly on

British reports, owing to the comparatively short experience of American companies.

I. REMUNERATION OF DIRECTORS.—“Founders shares,” as noted in an earlier chapter, are not found to any extent among British investment trusts, nor is compensation to directors or organizers commonly taken in the form of favorable purchase options. Nevertheless, there is clear recognition of the wisdom of an adequate remuneration for directors, consistent with the amount of time and energy which the faithful performance of their duties requires. This remuneration frequently takes the form of annual lump sum payments under the item “directors’ fees.” For instance, the Industrial and General Trust, for the year 1924-1925, reported expenditures of £12,500 under the head of Directors’ Fees; the Railway Share Trust and Agency Company reported £2,000; the Omnium Investment Company, £3,675 (1923); and the Mercantile Investment and General Trust Company, £6,000. Another provision frequently found is to the effect that any amounts remaining from the percentage expense appropriations, after all administrative outlays have been made, should accrue to the directors. The Investment Trust Corporation for thirty-six years operated upon the following basis of management charge, which was fixed at the time of launching the company:  $\frac{1}{2}\%$  annually on the first £500,000 of capital, and  $\frac{1}{4}\%$  on any capital above that amount. All expenses, exclusive of legal costs and auditors’ fees, were met out of this fund by the directors, who retained the balance, if any, as their own remuneration. In 1925 a lump sum of £2,500 was added to the above, which, in the words of the Chairman, “will enable us to meet further payments in connection with the running of the company, either to the directors or otherwise, that time may bring about.” It is of interest to note that the directors of British trusts are commonly required to possess a minimum amount of stock.



2. GENERAL EXPENSES.—The following provisions from the articles of association of the newly organized Second Guardian Trust (1924) are typical of allowance for management expenses, and resemble the last-mentioned arrangements in the matter of directors' remuneration.

#### THE SECOND GUARDIAN TRUST

For meeting the management expenses of the Company (as hereinafter defined) during every financial year, the Directors shall set aside out of the income of the Company for such year a sum equal to one-half per cent on the Company's issued Share, Stock and Debenture Capital as at the end of such year, and so in proportion for any period other than a complete year for which the Company's accounts are made up; and no management expenses in excess of the sums so set aside shall be incurred by the Directors without the authority or sanction of the Company in General Meeting.

Out of the sum so set aside in each financial year or period the Directors shall meet and discharge all the management expenses of the Company during such year or period including the remuneration of the Directors who shall be entitled to receive as their remuneration for their services during such year or period any balance of the sum so set aside remaining after payment of all the other management expenses, but so that the Company in General Meeting may at any time vote the Directors further remuneration for their services. Such remuneration shall be divided between the Directors in such proportions and manner as they may agree, and failing agreement equally.

For the purposes of the foregoing Articles the expression "management expenses" shall mean and include rent of offices, rates, stationery and other ordinary office expenses, salaries of and remuneration to the secretary, managers, clerks and other employees, directors' ordinary remuneration, and generally all ordinary management and administrative expenses and outgoings of the Company, but shall not include commission or brokerage payable on purchases, sales or changes of securities and investments, auditors' fees, legal expenses, income tax or other taxes.

3. BROKERAGE AND LEGAL FEES.—Legal fees, auditors' charges, and trustees' fees on bond issues are frequently, if not generally, segregated from ordinary administrative ex-

penses, although in the reports of many companies the item "management expenses" covers practically all outlays. Brokerage fees are added to the cost of investments, or subtracted from the realization price, as the case may be.

**Ratios of Administrative Expense.**—In Appendix G the reader will find the actual management expenses of leading English and Scottish investment trusts, as compared with their outstanding capital. The percentage of such expense runs as high as 1% or over for a very few such companies, but the average is .44% for twenty-three leading London trusts and .38% for twenty-one Scottish companies. These low ratios of administrative cost are made possible by the group management characteristic of British trusts, which unites the capital of several companies and permits the same staff to supervise a number of portfolios. Without a large initial capital, or a group arrangement of this kind, no newly organized investment trust should count upon so low a ratio of management expense.

**Expense Arrangements among American Investment Trusts.**—It will be of interest to note here a few arrangements for administrative expense, and the remuneration of organizers and directors, which have been adopted by American investment trusts.

The International Securities Trust of America pays a small percentage of its gross income to its fiscal agent, the American Founders Trust, for services in managing the portfolio under direction of the former's trustees. Trustees are paid the nominal fee for attending meetings of the board. Organizers' profits are represented in options on common shares of the International Securities Trust of America, granted to the American Founders Trust in proportion to the amount of capital which the latter raises for the former, and under definitive restrictions as to their exercise.

The Bond Investment Trust, which is managed by Harris, Forbes & Company (Boston) first pays the current rate (5%

at time of writing) on its "Certificates of beneficial interest," and from the surplus the operating expenses are met, no maximum ratio being fixed. The Declaration of Trust reads:

The Trustees may from time to time hire suitable offices for the transaction of the business of the Trust, appoint, remove or reappoint such officers or agents (including a Depositary) and also agents to sell certificates of beneficial interest herein as they may think best, define their duties, and fix their compensation. The trustees may employ one of their own number for special services to the Trust, and pay him therefor an amount in addition to his services as Trustee. The compensation of the Trustees as such shall not at any time exceed five per cent of the gross income of the Trust Fund, and one per cent of the amount distributed or conveyed upon final distribution or conveyance.

The Investment Managers Company, which issues "investment trust certificates" against an "investment fund" deposited with the trustee, and supervises the portfolio in the interest of these certificate holders, derives its compensation from the following three sources:

- (a) 1% on the face value of Certificates when issued, to be paid by the subscriber in addition to the amount of his subscription.
- (b)  $\frac{1}{8}$  of 1% quarterly on the actual value of the Investment Fund on the last day of each quarter.
- (c) 1% on the actual value of Certificates as of the date as of which they may be redeemed.

In the prospectus it is also stated that:

Neither the Company, nor its directors nor firms of which they are members, may have dealings in respect of the Investment Fund as principals in the purchase or sale of securities.

The expenses of the trustee and auditor are paid by the Investment Managers Company, which also covenants to meet any costs in the preparation and sale of certificates.

**Dividends on Common Stock.**—When allowance has been made for administrative expenses, for all incidental expenses, and for debenture interest and dividends on preferred stock, it will be seen by consulting Appendix G that the net available for distribution on common shares averaged, for twenty-one representative Scottish companies, 13.84% of outstanding common in 1923-1924, and 14.49% in 1924-1925; whereas the percentages for twenty-three London companies were 9.86% and 10.83% for the two years respectively. To quote from the *London Times*, whose compilations are utilized in Appendix G:

This excellent result was largely brought about by the companies taking advantage of the opportunities offered from time to time of making judicious exchanges in securities. There are a number of short dated investments appearing in the published lists bearing high rates of interest, which will possibly have to be replaced by others returning lower rates, but the margin of safety represented by the undivided surplus . . . should amply provide for this contingency without imperilling the rate of dividends at present paid or excluding the possibility of further increasing them. . . . The debenture interest and preference dividends are covered about twice over, and these stocks constitute first class securities. . . . In view of the conservative policy so universally adopted by these companies when recommending and paying dividends, we regard the position of the ordinary stockholders as well secured.

It is interesting to observe that the twenty-one Scottish trusts in question had available for distribution on common shares in 1924-1925 the sum of £1,062,398, of which £739,619, or less than 70%, was actually paid in dividends; for the preceding year, £920,591 was available, and but £654,211, or 71%, was paid. The twenty-three London investment trusts had available for common, as the result of their operations in the year 1924-1925, the sum of £1,647,297, of which £1,174,993, or about 71½%, was distributed; in 1923-1924, £1,435,209 was available and £1,054,090, or 73½%, was paid out in dividends. Bearing in mind the universal British practice of reinvesting gains on turnover, the reader will realize how important



among English and Scottish trusts is the policy of regularly re-investing at compound interest a substantial proportion of earnings. For the year 1924-1925 an amount was put aside from the investment yield alone, equal, in the case of the aforesaid Scottish companies, to 4.40% of the outstanding common shares, and in the case of the London companies, to 3.11%. For the previous year the percentages were 4% and 2.62%, respectively.

The policies of American trusts have not yet been clearly determined in the matter of reserve accumulation, but save in the case of the "stock conversion" or "bankers share" companies (express trusts), prospectuses, trust agreements, and articles of association make clear the duties of the trustees or directors to accumulate such reserves as in their discretion seem advisable. The International Securities Trust of America binds its trustees to set aside annually a percentage of earnings accumulating as the "bond interest" and "preferred dividend" reserve funds, and in addition reinvests a proportion of remaining net earnings. The conditions under which the "investment trust certificates" of the Investment Managers Company are issued calls for a constant accumulation of reserves increasing at compound interest.

**Rate of Common Dividends.**—Despite their ultra-conservative policies of accumulating surplus and reserves, both balance sheet and concealed (but fundamentally for this very reason), the dividends paid by British investment trusts have been on the whole as liberal as any reasonable person could expect, bearing in mind the great steadiness of these rates, or their gradual increase, over any period of time. At least a dozen London companies paid 10% or over in 1924-1925, and eighteen or more Edinburgh and Glasgow trusts did the same; 12% and over is commonly distributed, while at least two London trusts, and five Scottish companies gave 15% or over to their common shareholders in this year. The average divi-



dend on common shares paid by the Scottish companies listed in Appendix G was 10.09% in 1924-1925, and 9.84% in the preceding year; for the London companies listed in the same table it was 7.72% and 7.24% respectively.

**"Interim" and "Final" Dividends.**—In studying dividend figures of British investment trusts great importance attaches to a correct interpretation of the percentages for "interim" and "final" dividends, and it is unfortunate that uniformity does not obtain among these companies in methods of reporting. Certain trusts, for instance, declare "interim" dividends at some time during the fiscal year, expressed as percentages of the amount of outstanding common stock, while at the close of the year a "final" dividend is voted, also expressed in this way. Regardless of the time at which the "interim" dividend has been declared, the entire dividend in such cases is easily computed by adding the percentages of two dividends. The following appropriation account will make this clear:

THE MERCANTILE INVESTMENT AND GENERAL TRUST COMPANY, LTD.  
Year Ended 31st January, 1925

"B" REVENUE ACCOUNT

Dr.	£	s.	d.		£	s.	d.
To Balance from "A" Revenue Account.	33,100	0	4	By Dividends and Interest, less Income tax, in respect of which the Company is not liable for Corporation Profits Tax. . . . .	223,970	1	7
To Interim Dividend of 4½% on the Ordinary Stock, paid 1st August, 1924, less Income tax. . .	52,311	12	0	By Balance from last year. . . . .	81,547	11	2
To Proposed Final Dividend of 7½% on the Ordinary Stock (making 12% for the year) less Income tax. . .	87,187	10	0				
To Amount transferred to Reserve Account. . . . .	50,000	0	0				
To Balance carried forward, subject to Corporation Profits Tax (if any) . . .	82,918	10	5				
	<u>£305,517</u>	<u>12</u>	<u>9</u>		<u>£305,517</u>	<u>12</u>	<u>9</u>

Among many other trusts, however, a different practice prevails in describing "interim" and "final" dividends. Both are expressed as equivalent to a certain annual percentage on the outstanding common, over the portion of the fiscal year covered by each dividend. As the "interim" dividend in such cases is usually declared at the half year, the rate of the total dividend for the year is computed by adding the two percentages and halving the sum. But care should be taken in this event to ascertain that the "interim" dividend covered only the half year. Another appropriation account will illustrate this:

THE FOREIGN, AMERICAN, AND GENERAL INVESTMENTS TRUST COMPANY, LTD.  
Account to March 15, 1925

APPROPRIATION ACCOUNT

<i>Dr.</i>				<i>Cr.</i>					
	£	s.	d.	£	s.	d.	£	s.	d.
To Interim Dividend at the Rate of 5% per Annum on Deferred Stock paid for 6 months to September 15th, 1924.....	18,750	0	0				By Balance from Last Account.	45,555	14 5
Less Income Tax at 4s. 6d. ....	4,218	15	0				By Balance from Revenue Account "B"...	61,382	17 1
	<hr/>			14,531	5	0			
To Proposed Dividend at the Rate of 10% per Annum on Deferred Stock for the last half-year, making with above Interim payment a Dividend of 7½% for the year.....	37,500	0	0						
Less Income Tax at 4s. 6d. ....	8,437	10	0						
	<hr/>			29,062	10	0			
							43,593	15	0
							22,789	2	1
To Amount Transferred to Capital Reserve Account									
To Balance Carried to Next Account subject to Corporation Profits Tax (if any).....							40,555	14	5
							<hr/>		
							£106,938	11	6
							<hr/>		
							£106,938	11	6

**Dividends an Insufficient Criterion.**—It is perhaps particularly true with investment trusts that the advantages accru-

ing to common shareholders are but partly expressed in terms of current dividends. Where, as in the United Kingdom, new issues of trusts are readily absorbed and frequently sold at a premium, prior subscription rights are a valuable privilege.

Skilful administration will occasionally find ways of strengthening the trust always to the advantage of the shareholders; or of translating into more negotiable forms, without in any way weakening the trust, its salient features of strength. Let us say that common stock has been paying 15% for some time, and that this is a conservative distribution. It may be decided to segregate and mark half of the common stock outstanding as entitled to a steady preference dividend of 10%, the remainder enjoying what is left, which would presumably be at the rate of 20% upon the latter. Such action might immediately give a calculable market value to the newly created "preferred ordinary shares," enabling the holder, by selling them, to withdraw the greater part or all of his original investment if he desired to do so, without a commensurate sacrifice of his share of the anticipated greater earnings of his company in the future.

For instance, to cite a comparable example, the action described in the following quotation was taken in the interest of the common shareholders of a prominent Scottish investment trust, nearly two-thirds of whose portfolio is composed of American investments:

THE SCOTTISH AMERICAN INVESTMENT COMPANY, LIMITED

SHARE CAPITAL.—Extraordinary General Meetings of the Company were held during March and April 1924, when Resolutions were passed and duly confirmed, viz.:

1. To increase the Capital from £2,100,000 to £2,800,000 by the creation of 700,000 Shares of £1 each, to be called "A" Ordinary Shares.
2. To subdivide the existing 350,000 Ordinary Shares of £2 each into 700,000 10 per cent "B" Ordinary Shares of £1 each.

3. To authorize the Directors to capitalize the whole or any part of the Reserve Fund or undivided profits.

On 9th April last the Directors capitalized £400,000, being part of the Reserve Fund, in the form of 400,000 "A" Ordinary Shares of £1 each fully paid. The new Certificates were issued to Shareholders on 10th April 1924.

RESERVE FUND.—This Fund stood at 31st			
December 1923 at . . . . .	£950,000	0	0
<i>Deduct:</i> Amount capitalized as stated above	400,000	0	0
	£550,000	0	0
<i>Add:</i> Sum transferred from Revenue Account . . . . .	25,000	0	0
	£575,000	0	0
Making a Total of . . . . .			

#### COMPARATIVE REVENUE ACCOUNT FOR YEAR TO 31ST DECEMBER

	1923	1924
Income.....	£274,322	£296,531
<i>Less:</i>		
Interest, less tax.....	£ 33,469	£ 33,983
Expenses.....	13,103	15,028
Income tax, etc. ....	65,479	66,833
Preference dividend, less tax.....	43,030	43,400
Balance for Ordinary Shares.....	£119,241	£137,287
£2 Ordinary Share Dividend, less tax, 18%.....	96,863	...
10% "B" Ordinary Share Dividend, less tax.....	...	54,250
"A" Ordinary Share Dividend, less tax.....	...	(15%) 46,500
	£ 22,378	£ 36,537

To summarize the effects of the above capital rearrangements so far as the common shareholders are concerned, let us note that in 1923 the latter received in dividends on their "ordinary" shares of £2 par the amount of £96,863, being at the rate of 18%; that in 1924 they received £54,250 as a dividend on their new 10% "B" ordinary shares (into which their former shares had been converted on a basis of two to one), and also dividends of 15%, amounting to £46,500, on the newly created "A" ordinary shares, which represent the capitalization

of less than half the reserve fund, and which were distributed as a bonus to common shareholders. The entire dividend paid on common was therefore increased but £4,000 in 1924 as compared with 1923, but the owners of common stock profited considerably in the enhanced selling value of their holdings.

Dividends alone are, therefore, at best a crude criterion for comparing companies, and they tell very little about the gains which the original investors have enjoyed. For them the important consideration is the actual cash paid for each share of stock. A ten pound share may represent fifteen or twenty pounds if reorganization has followed an earlier failure; or it may represent less than ten pounds of original capital if the company has issued bonus shares.

Furthermore, the underlying value of stock is as much a matter of equity in case of winding-up as of current dividends. Though their principles of accounting are quite uniform, some British trusts are naturally more conservative than others in distributing net income, capitalizing reserves and allowing for depreciation in investments. Robert Fleming and Company, for instance, discourage the capitalization of reserves by issues of bonus stock. In Appendix G are also given the (London) *Financial Times* compilations of "Reserves and Carry Forward" for the above-mentioned representative British trusts, as compared with their outstanding common stock. In some cases the former is as much as 150%, or more, of the latter (Alliance Trust, British Investment Trust, Northern American Trust Company, Metropolitan Trust Company); while the average is 43.96% for the London companies and 85.70% for the Scottish trusts. This equity has been consistently built up by shunting a portion of net investment earnings to reserves, even during those years when most liberal dividends were being paid.

The calculation of net "break-up" value at any time for the common stock of these British trusts is, of course, a more complex process, for this is dependent not only upon the equity



position of common shareholders as disclosed by published balance sheets, but also upon the difference between current values of the trust's investments, and the amounts at which they are held in the accountants' books. That these figures are often far apart appears in the next chapter; but since the portfolio is never held in the balance sheet at a figure in excess of cost, the calculation of "break-up" value at any time, and with reference to current quotations, will in many cases produce a tentative figure in excess of that resulting from analysis of the balance sheet. How much excess, if any, depends upon the previous policy of each investment trust in accumulating concealed reserves, as well as the state of the stock exchange market at the time.

**Values and Yields of Investment Trust Securities.**—As the British trusts have faithfully met interest on their debentures and the claims of preferred stock, the values of these securities have not had a different course than for any other similar high-grade investments. In general, the fixed interest-bearing issues reached their high mark before the war, and had quite uniformly fallen in value to the time of the general upturn which, despite occasional recessions, has accompanied the post-war easing of money rates. They have long been below par because of the heavy income taxes.

At the prices of the summer of 1925 debentures of the leading Scottish trusts netted an average yield to new purchasers of about 5%, and debentures of representative London trusts of about  $5\frac{1}{2}\%$ . At the prices for preference shares, the average yield was about 5.30% on Scottish shares, and 5.40% on London shares. Scarcely more than two years have passed, in fact, since a certain prominent London trust decided upon a new issue of debentures. So strongly entrenched was this company, and so closely was its stock held, that the bond issue was offered at a yield practically equivalent to, if not a trifle below, the rate which British Government obligations were then

netting the buyers. When jocularly accused at one time of presuming to rate the credit of his company as equivalent to that of the Exchequer, the manager merely remarked, "But, financially speaking, we have made less mistakes than the British Government!" The entire issue was easily absorbed without underwriting or special effort.

Ordinary stock of investment trusts generally reached the low point in price some time in the period 1915-1918, and has been climbing since. For a number of very successful trusts the bottom was reached in 1920-1921. The high mark is generally before the war—a circumstance largely due to the income tax. Despite the tax, however, the lowest quotation during the war for the ordinary stock of at least twenty trusts did not go below eighty pounds on a par value of a hundred, and in the case of ten companies the low quotation was well over a hundred.

At the prices of the summer of 1925 the average yield on common stock of the Scottish trusts in Appendix G was only 5%, approximately the debenture yield, and about  $\frac{1}{3}\%$  less than the preference yield; while for the London companies, the average yield on common was about 5.9%. These surprisingly low yields for the Scottish companies especially reflect the strong reserve position of the trusts, and the public confidence which consistent and dependable dividend policies have created. The common shares of British investment trusts are among the highest priced and most tenaciously held deferred stocks in the United Kingdom.

## CHAPTER X

### EARNINGS OF INVESTMENT TRUSTS (CONTINUED)

**Analysis of Some Typical Companies.**—In the preceding chapter the present earnings, dividends, and reserve strength of investment trusts have been studied, as well as the yield on their different types of capital. In this chapter the accounts of a few typical trusts will be reviewed in detail during the entire period of their existence, as only in this way can a clear understanding be gained of the investment trust as a “going concern.” An analysis will also be attempted of the dividends of some fifty-five British trusts during the last twelve years. Let us take for the former purpose the First and Second Edinburgh Investment Trusts.

**Statistical Chronicle of the Edinburgh Investment Trust.**  
—Column (1) of the table below <sup>1</sup> shows the net revenue from interest and dividends of the Edinburgh Investment Trust after all administrative expenses have been deducted, and the debenture and preferred stockholders paid. Column (2) gives the amount of this available fund which has actually been distributed from year to year, and the dividend rate follows in column (3). Under column (4) appear the accumulating amounts which are carried forward from year to year in the revenue account, being composed for the most part of the net under column (1) which has not been distributed, used to “write off” depreciated securities, or shunted into the reserve account. Column (5) indicates profits from turnover of holdings, and the two following columns account every year for the use of the entire amount, either in the concealed reserve

<sup>1</sup> Most of these figures are not official. They are computed from data which the writer has analyzed in the offices of the companies, and the arrangement of the table is the author's.

## EDINBURGH INVESTMENT TRUST

FIGURES TO NEAREST £500

Year	1	2	3	4	5	6	7	8
	Balance of income available for deferred	Distributed to deferred	Percentage of dividend	Balance on revenue account carried forward	Profits on realizations	To depreciation account therefrom	To reserve therefrom	Reserve
	£	£	%	£	£	£	£	£
1889.								
1890.	6,000	4,000	8	1,000	9,500		9,500	11,500 <sup>b</sup>
1891.	11,000	9,500	7	500	2,000		2,000	27,500 <sup>b</sup>
1892.	12,000	8,000	5	1,000	500	580		20,000
1893.	10,000	8,000	5	500	4,500	4,500		20,000
1894.	6,500	6,500	4	500	5,000	5,000		
1895.	4,000	3,000	2	1,000	2,000	2,000		
1896.	2,500	3,000	2	500	4,500	4,500		
1897.	6,000	5,000	3	1,500	3,000	3,000		
1898.	7,000	5,000	3	3,500	8,000	8,000		
1899.	9,500	8,000	6	5,000	4,500	4,500		
1900.	10,500	8,000	5	4,500	3,500	3,500		
1901.	14,000	9,500	8	5,000	8,000		8,000	3,000
1902.	14,000	11,000	7	8,000	14,500		14,500	15,000
1903.	15,000	11,000	7	8,500	17,000			30,000
1904.	16,000	11,000	7	13,500	1,000		1,000	50,000
1905.	15,500	13,000	8	13,000	8,500		8,500	50,000
1906.	18,000	13,000	8	14,000	16,500		18,500	62,500
1907.	24,000	19,000	10	19,500	10,000	500	9,500	90,000 <sup>b</sup>
1908.	35,500	19,000	10	23,500	5,500	5,500		100,000
1909.	29,000	19,000	10	24,500	19,000	9,000	10,000	110,000
1910.	28,500	26,500	14	26,500	28,000	18,000	10,000	120,000
1911.	35,000	30,000	10	29,000	12,000	2,000	10,000	130,000
1912.	34,500	30,500	16	31,500	22,000	12,000	10,000	140,000
1913.	41,000	32,000	17	35,000	18,000	8,000	10,000	150,000
1914.	46,000	32,000	17	43,000	7,500	7,500		150,000
1915.	36,000	31,500	17	47,500	18,000	18,000		150,000
1916.	42,000	34,500	20	55,000	6,500	6,500		150,000
1917.	48,000	30,500	20	72,600				150,000
1918.	45,500	30,000	20	88,000				250,000 <sup>c</sup>
1919.	48,500	28,500	20	39,000	1,000	1,000		200,000 <sup>d</sup>
1920.	57,000	33,500	20	42,500	2,000	500 <sup>a</sup>		100,000 <sup>e</sup>
1921.	53,500	33,500	10	62,000	1,000	1,000		100,000
1922.	43,000	33,500	10	65,000	500	500		100,000
1924.	57,000	44,500	12	96,500	<sup>f</sup>			100,000

<sup>a</sup> Expenses of new issue of stock deducted.<sup>b</sup> Partly from premiums on issues of new shares.

<sup>c</sup> From minutes of Annual Meeting, 1918.—“In view of the proportion of the Company's assets now invested in British Government securities, it is unnecessary to retain so large a depreciation account . . . £100,000 has therefore been carried from that account to the reserve fund. . . There remains at the credit of the depreciation account the sum of £132,769. . .”

<sup>d</sup> In this year a bonus was given to the ordinary stockholders of £160,000, distributed in the form of £64,000 in debentures, £58,000 in 4½% preferred, and £38,000 in ordinary stock. In addition, the preferred stockholders received £9,000 as a bonus.

The reserve of £250,000 of 1918 was, therefore, reduced to £81,000. To this £69,000 was added from the surplus revenue (column 4) and £50,000 from the depreciation fund, making the reserve stand at £200,000.

<sup>e</sup> To the reserve of the preceding year £120,000 has been added from the depreciation fund (not shown in the table). A bonus of £240,000 in ordinary stock has been distributed, reducing the reserve to less than £100,000. The difference is made up from surplus revenue. By this bonus the ordinary stock outstanding is increased from £340,000 to £480,000, thereby halving the dividend of the following years (1921-1922) (see column 3).

<sup>f</sup> Profits on realization are no longer given.

(column 6), or in increasing the balance-sheet reserve (column 7). The last column shows this reserve, i.e., the equivalent of reserve and surplus. Because so many items are left out of so compressed a table it must not be expected that the several columns will always exactly supplement each other. The foot-notes explain the recent changes in column (8).

### **A Cardinal Principle of Investment Trust Management.**

—The chairman of the Edinburgh Company states that the secret of investment trust management is to avoid losses on holdings, and allow a portion of net revenue continually to accumulate at compound interest. There are three factors of reserve power in the trust we are considering—the accumulations under columns (4), (6) and (8). Column (6) shows only that part of the contingent fund or concealed reserve which has been contributed by profits on realizations. Interest from the securities representing these funds enters the annual income statements and is more than returned in the margin regularly set aside for one kind or another of reserve. However, the Company in its earlier history was not successful in avoiding heavy depreciation of its holdings, an experience which it shared at this period with all other companies.

**Early Difficulties.**—The Edinburgh Investment Trust had hardly been launched before the Baring crisis broke over England. Precipitated by South American difficulties, this tremendous shaking-up of the British financial system left its effects in every part of the industrial world. Shadows of the London crash, coupled with too eager industrial expansion and a government policy of monetary inflation, brought on the United States panic of 1894. As investment trusts were heavily involved in the United States, as well as in Argentina, they keenly felt the industrial stagnation of the early and mid-nineties. The dividend rate of the Edinburgh Company fell from 8% in 1890 and 7% in the following year, to 2% and 3% from 1895 to 1898. As compared with the preceding and



following years, the profits on realizations were scanty, and they were immediately used to write off certain depreciated securities. The reserve was reduced for the same purpose in 1892, and two years after that it disappeared altogether, being more than used up to meet the losses of the lean period. It is impossible to say whether the management would have been so conscientious in keeping the balance sheet figure on investments in line with slumping market values if the principles of the Verner case had been established at the time. At any rate no visible reserve reappeared until 1901, and the balance on revenue account made no appreciable advance until the late nineties.

**Remarkable Gains with Conservative Management.—**

From 1899 we follow an absorbing account of the way in which money may multiply itself by conservative investment. The Edinburgh Trust weathered the crises without once passing dividends, but the struggle of the nineties had taught it principles of management which were responsible for the unbroken rise in its dividends to the present time. The reserve grew rapidly, and the increasing profits on realizations were entirely used to augment it from 1901 to 1906. Similarly, the balance carried forward on revenue account showed a regular advance to 1918. In column (5) in the statistical chronicle there are reflections of unsettled conditions in 1904 and 1905, and again in 1907 and 1908, but from the latter year, and up to the outbreak of the war, the capital profits were great enough to split between the "visible" and "inner" or "invisible" reserve.

**Building Reserves.—**In the annual meeting of 1910 we read that "In view of the reserves which have been accumulated, the directors consider that a greater proportion than hitherto of the interest and dividends received may be distributed, and that profits on sales of investments should suffice for any further strengthening of the reserves." The results may be traced in columns (1) and (2). To visualize the

meaning of this statement we must first place side by side the annual valuation of the Company's holdings, and the figure at which these holdings appear in the balance sheet. Little information concerning the former is disclosed before 1899, when the statement is made that "the usual valuation shows that the assets fully equal the capital." Prior to that time they were probably far below. It may be assumed that assets as a whole show little or no depreciation in the period between 1899 and 1908. In the latter year the directors again declare the capital is unimpaired.

The following table shows excess of actual valuation over balance-sheet figures in the years after 1908:

1909.....	£ 80,000
1910.....	150,000
1911.....	150,000
1912.....	150,000
1913.....	135,000
1914.....	125,000
1915.....	30,000
1916.....	100,000
1917.....	145,000
1918.....	135,000
1919.....	185,000
1920.....	245,000

**Calculating Reserves.**—It must be borne in mind that the total reserves are as much more than these figures, year by year, as the amount of (visible) "reserve" and "revenue carried forward" appearing in the balance sheet. These figures are the more remarkable when it is noted that in 1918 £100,000 had been carried to the (visible) reserve, reducing by that amount the above figure for that year, and converting an apparent loss of £10,000 in surplus valuation to an actual gain of about £90,000. The reasons for this transfer from concealed to "visible" reserve are given in the third footnote to the table. Furthermore, in 1919 a stock bonus of nearly £170,000 was distributed, and in redressing the accounts to meet this increase in share capital, a further appropriation of £50,000 was made from the depreciation account (see footnote d). Similarly in

1920, an added sum of £120,000 was credited to the visible reserve from the depreciation account to permit of a distribution of £240,000 in bonus ordinary shares to the common stockholders (see footnote e).

If there is added to the excess valuation of the latter year, which is £245,000, the figure for "reserve" appearing in the balance sheet of 1920 (£100,000) and the amount for "balance on revenue account carried forward" (£42,500) there is a total of nearly £390,000. This represents the difference between the entire outstanding capital of every kind (debenture, ordinary, and preferred) and the valuation at current prices of all the Trust's holdings. In other words, the equity behind the common stock is the sum of this figure and the equivalent of the common stock (now £480,000), or about £870,000. This represents a "break-up" value of more than £180 for each £100 of common stock, notwithstanding the fact that the common stock has just been doubled by a bonus issue. To gain a correct view of the position of the original ordinary stockholder at this time, it must be borne in mind that the bonus issues referred to above increased the common stock outstanding from £200,000 to £480,000, and in addition gave the shareholder a handsome block of debentures and preferred. The equity of £870,000 mentioned above must be compared with the original investment of £200,000, from which it appears that every pound originally put in the ordinary stock has been nearly quintupled despite the high rates of dividend paid in the preceding twenty years.

**The War Chapter—and After.**—So far the only unfavorable effect of the war seems to be the heavy depreciation in 1915, which is followed by an extraordinary advance in values reflecting the heyday of war prosperity. The excess valuation keeps climbing until 1920. What follows is equally interesting:

In 1921 the valuation is £70,000 *less* than the balance-sheet figure for investments

In 1922 the valuation is £40,000 *less* than the balance-sheet figure for investments

The 1921 figure reveals a depreciation from the previous year of over £300,000 in investments—a tumble of about 18%. This fall can be accounted for in several ways. The policy of the Edinburgh Trust has been to invest considerable funds in common shares. The wise selection of these junior securities in part explains the high figure of 1920, when business was still booming. The slowing-up of production depreciated these holdings, though they are still in excess of cost. The principal shrinkage arises in Government bonds, of which this Company now holds large blocks, and fixed interest-bearing securities. The rise in interest rates attending the period of liquidation sufficiently explains the drop.

**Reserves to the Rescue.**—The reserves were so strong, however, that in 1921 the capital was not only unimpaired, but a surplus remained amounting to over £90,000, i.e., the equity for the common stock is reduced to £570,000, which is £90,000 in excess of the par value of outstanding ordinary shares. In 1922 the depreciation had decreased to £40,000, and the equity stood at an amount of at least £600,000. The author was then informed by the directorate, however, that owing to the easing in interest rates and a better business outlook, the current value of holdings was at least equivalent to the balance-sheet figure. Assuming this to be true, the equity for the common stock was fully £640,000, which represented more than three-fold the original investment,<sup>2</sup> at a time when the stock was itself drawing a dividend of 10%.

The uninterrupted dividend was due to the way in which the concealed or inner reserve absorbed a large part of the shock of heavy depreciation, and the revenue surplus and regular reserves further cushioned the blow. Through the times of war

<sup>2</sup> The original shares (1886) were issued at £10. After payment they were converted into preferred and common at a ratio of 6 to 4 respectively. In other words, for each £10 invested the shareholder received £6 in preferred and £4 in ordinary. It is only in the latter that the pyramiding of values occurs.

peril and after-war adjustment the Company sailed serenely, and there is every indication that even better days await it. The dividend is now 12%, and in the report for the year ended March 15, 1925, the Directors state that the investments are worth over £340,000 more than the amount at which they appear in the balance sheet.

**The Second Edinburgh Investment Trust.**—The Second Edinburgh Trust was organized in 1902 and is under the same management as the Edinburgh Investment Trust. The policy in distributing available income has been different, as will be seen in the figures below.

There was a steady rise in the dividend rate from  $3\frac{1}{2}\%$  in

### THE SECOND EDINBURGH INVESTMENT TRUST<sup>a</sup>

FIGURES TO NEAREST £500

Year	1 Balance of income available for deferred	2 Distrib- uted to deferred	3 Percent- age of dividend	4 Profits on realiza- tions <sup>b</sup>	5 Reserve
	£	£	%	£	£
1903.....	6,000	3,500	$3\frac{1}{2}$	1,500	.....
1904.....	6,500	4,500	$4\frac{1}{2}$	2,500	.....
1905.....	8,000	4,500	5	17,000	.....
1906.....	10,000	5,500	6	17,500	15,000 <sup>c</sup>
1907.....	14,000	5,500	6	7,500	30,000 <sup>c</sup>
1908.....	13,500	7,500	8	12,500	30,000
1909.....	12,000	8,500	8	7,500	30,000
1910.....	14,500	8,500	8	16,500	40,000 <sup>c</sup>
1911.....	17,000	9,000	8	9,500	40,000
1912.....	17,500	9,000	8	10,500	50,000 <sup>c</sup>
1913.....	21,500	14,500	12	6,000	50,000
1914.....	21,000	14,500	12	5,000	50,000
1915.....	24,000	13,500	12	9,500	50,000
1916.....	34,500	15,500	15	1,000	50,000
1917.....	31,000	14,500	15	1,000	50,000
1918.....	30,500	16,500	15	500	50,000
1919.....	34,500	15,500	15	2,500	160,000 <sup>c</sup>
1920.....	43,500	15,500	15	3,500	100,000 <sup>d</sup>
1921.....	35,000	21,000	15	500	100,000
1924.....	40,000	23,000	15	"	100,000

<sup>a</sup> Columns 1, 2 and 3 to 1917 are taken from 1917 annual report of the company. For the later years and columns 4 and 5, figures are compiled from revenue accounts.

<sup>b</sup> Includes premiums on issue of debenture stock.

<sup>c</sup> By transfer from depreciation account, or invisible reserve.

<sup>d</sup> Reduction of reserve by issues of bonus shares.

<sup>e</sup> Not given in present reports.



1903 to 15% from 1916 to 1925. Moreover, the net income was sufficient to justify bonus issues in ordinary stock totalling £90,000 in the years 1909, 1911, 1918 and 1921. The distribution was effected by writing profits into the contingent fund, or concealed reserve, transferring sums from the latter to the balance-sheet reserve and reducing this reserve in proportion to the increase in stock.

**Contrasted Dividend Policies.**—Comparing columns (1) and (2) of each of the foregoing tables it will be seen that the older company has regularly distributed a larger proportion of its net revenue, and issued a relatively greater volume of bonus shares. The equity for each £100 of common stock in the Second Edinburgh Company is, therefore, greater. The amount of ordinary shares outstanding for this company is £200,000, and the 1924 valuation shows the equity for common to be £635,000. By allowing for the £90,000 of bonus stock issue we reduce the cost of outstanding common to £110,000. At the current valuation of its holdings the Second Company has therefore more than quintupled the original investment in its ordinary stock, despite the regular dividend of 15%.

**Distribution of Investments.**—Each company during its entire history has widely distributed its investments. The Edinburgh Trust has had from two hundred and fifty to three hundred different holdings, with amounts varying from £2,500 to £14,000 invested in each. In common with other organizations, these companies have heavily invested in war issues, so that figures given for diversification of their investments exclude government bonds—the amount of which was so greatly enhanced by earlier liquidation of American securities.

**War Liquidation Not Profitable.**—A fact worth noting is that these two companies barely balanced losses with gains from the sale of their American securities during the war. At a time when exchange was much in their favor through the

stiffening of the dollar and other neutral currencies, it seems peculiar that sale under the compulsion of war need was not more profitable. It has been generally the case that investment trusts liquidated many profitable holdings at a distinct loss to increase their participation in war loans, and such wholesale dumping of investments has not permitted the holding of each security until the right time for realization. If common stocks were high, preferred stocks and bonds were low. While high exchange cancelled many losses and increased some gains, it did not generally do more than "wipe the slate clean."

**Dividends of British Investment Trusts during Recent Years.**—The following analysis of dividends paid by various British investment trusts is based upon a comparative study of the fifty-five companies starred in the list of Section I, Appendix A. They are a thoroughly representative assortment. The following investment trusts in the list specified declared an average annual dividend of 10% or over during the entire period from 1912 to 1924 inclusive. Those starred have been conspicuously successful (15% or over).

The Alliance Trust Company \*  
The British Investment Trust  
Consolidated Trust  
Edinburgh Investment Trust \*  
Industrial and General Trust  
Investment Trust Corporation  
Metropolitan Trust Company  
River Plate and General Investment Trust Company  
United States Debenture Corporation

The following companies have enjoyed dividends averaging from 8 to 10% during the same period:

American Investment and General Trust Company  
Army and Navy Investment Trust Company  
Government and General Investment Company  
Indian and General Investment Trust

Merchants Trust  
Second Scottish Investment Trust Company

The following companies have paid dividends of at least 7% since the war, although their earnings during the war and before it were less. The companies starred have had remarkable profits since the war.

Alliance Investment Company  
Brewery and Commercial Investment Trust \*  
Caledonian Trust Company  
Debenture Securities Company  
General and Commercial Investment Trust  
General Investors and Trustees  
London and Colonial Investment Corporation  
London and New York Investment Corporation  
London Trust Company  
New Investment Company  
Third Edinburgh Investment Trust \*  
Trust Union  
United States and General Trust Corporation  
United States and South American Investment Trust  
Company

Thus it appears that fully one-quarter of the British investment trusts have been remarkably successful. Of the fifty-five in question, only a half dozen or so fell below 6% in 1921, their average dividend for that year being 4%. These same companies failed to pay an average of 5% during the ten-year period 1912 to 1921, but they are the only ones among the fifty-five which have been unfortunate to this extent.

**Causes of Failure.**—In checking over the comparatively unsuccessful companies, it is not easy to point out any common cause of failure. A number of trusts have suffered heavily because of the ambitious program of their early directors, who strayed far from sound investment policies. A few examples of abuse are cited in Chapter XI. In a number of instances the

writing down of the share capital has placed the company upon a firm basis. The Metropolitan Trust, which figures in the first list of successful companies, is a reorganization of an earlier failure. Companies departing from the practice of widely distributing their risks have now and again been hard hit by depression in certain industries—as in mines, iron and steel, and rubber. The increasing interest of British investment trusts in home industries (see Chapter XI) makes them more sensitive to the business disturbances of a highly industrialized community. Holdings of Russian bonds have somewhat embarrassed several trusts, and in one or two cases proved fatal to companies organized to specialize in them. For instance, the Scottish and Foreign Trust goes through the formality of annual meetings but reckons its assets a dead loss. However, comparative success or the reverse cannot be explained by reference to any particular area or industry. High dividends result from the skilful and yet cautious management which characterizes most British investment trusts of cosmopolitan interest. By referring to the analysis of the earnings of the two Edinburgh Trusts it will be seen that highest dividends often result from the most conservative direction.

**Average Dividends.**—The average dividends of the above mentioned fifty-five companies were over 7% in the years 1912 to 1914 inclusive; they were 6½% during the war period; and have been over 8% in the period following the war. Progressive improvement in earning power is generally notable during recent years. Nearly all of the unusually successful companies (those paying 10% or over) have an outstanding share and debenture capital of well over one million pounds, and were organized in the late eighties. Conversely, practically every large company formed in this earlier period of trust activity has more than justified the efforts of its founders. This suggests the soundness of the general principles underlying investment trusts.

**War Experience of Investment Trusts.**—The remarkable showing made by the trusts as a whole is particularly gratifying during the war period. Although business had its ups and downs, most of the companies combining a wise assortment of fixed interest-bearing and dividend-paying securities came through without a tremor. While dividends on ordinary stock were soaring for companies active in war industries, mounting interest rates brought down the values of bonds and preferred stock; but the trusts profited from the former without losing much because of the latter. The slight decrease in average dividends during the years 1915-1918 indicates losses of return from securities of certain industries embarrassed by the war, further deductions from income to write off depreciation in holdings, and the sale of desirable securities at even sacrifice prices to participate in war loans. The rates of dividend since the Armistice have been even higher, as a whole, than before August, 1914; and the position of the trusts is today so strong that it is difficult to purchase stock of the well-known British companies in the open market. The *London Financial Times* said in its issue of June 28, 1924:

The market in trust company stocks is a very limited one, and although sales can be readily effected, it is often difficult to purchase even small amounts. Those desiring to invest money in these stocks can best serve their purpose by leaving their orders with their brokers or agents for execution as opportunity offers.



## CHAPTER XI

### TENDENCIES IN BRITISH INVESTMENT TRUST DEVELOPMENT

**Tried Institutions in the United Kingdom.**—At the outset of our discussion of investment trust development in the United States and Europe, it will be wise to give a brief survey of the investment trust in the United Kingdom, which may be regarded as the homeland of companies of this type. A study of current tendencies ought, moreover, to be prefaced by a historical sketch.

**Chronological Survey.**—The British investment trusts given in Section I of Appendix A, are arranged in Appendix B according to date of their organization. By reference to this list it will be seen that the oldest investment trusts existent in the United Kingdom date from the early seventies, but that few were organized until the last year of that decade. The period of greatest organization activity was the three-year stretch from 1888 to 1890, over thirty trusts being created at this time. During the nineties comparatively few were organized, but further development appears from 1907 to the outbreak of the war. In 1924 and 1925 there has been considerable activity in launching new investment trusts.

About fifty companies in the list of Section I have at present an outstanding share and debenture capital equivalent to £500,000 or more. After roughly classifying these by size, the following shows their approximate dates of organization and discloses the interesting fact that more than half of these larger investment trusts, and nearly all those of greatest capital were organized in the period of the late eighties.

Outstanding Share and Debenture Capital	Number of Companies	Dates of Organization			
		Scattered	Seventies	1885-1890 inclusive	Since 1900
£ 500,000-£1,000,000..	20	2	1	7	10
£1,000,000-£2,000,000..	16	3	1	11	1
£2,000,000-£4,000,000..	12	3	3	5	1
£4,000,000 or above.....	4	..	..	4	..
	52	8	5	27	12

**Ratio of Debentures.**—Provided a company's borrowing power is well established, it will, of course, issue debentures on condition that an ample margin exists between the cost of obtaining money for long periods and the return which can be got from investing this money. By adding the totals for share and debenture capital of companies organized during the indicated periods we arrive at the following ratio of their outstanding debentures to their ordinary and preferred stock :

During the Years (inclusive)	There were Companies Organized	Having at Present the Following Ratio of Outstanding De- bentures to Share Capital
1860-1879.....	11	57 <sup>0</sup> / <sub>100</sub>
1880-1889.....	36	66 <sup>2</sup> / <sub>3</sub> <sup>0</sup> / <sub>100</sub>
1890-1899.....	12	63 <sup>0</sup> / <sub>100</sub>
1900-1909.....	11	50 <sup>0</sup> / <sub>100</sub>
1910-1920.....	15	38 <sup>0</sup> / <sub>100</sub>

It might be expected that the older an investment trust is, the larger will be the proportion of its capital raised by the sale of bonds. This circumstance does not altogether explain the diminishing ratio of debentures in recent years, for most of the companies established since 1900 have had adequate time to consolidate and use their borrowing power. A factor militating against new debenture issues is the limitation imposed by

companies upon their borrowing power. A number of older trusts have put out their full quota of debentures, and cannot expand without increasing share capital or altering the articles of association.

Of late there has been a greater disposition to borrow on bonds, and from some points of view recent years have proved propitious for the issue of investment trust debentures. The United States and General Trust Corporation, for instance, offered in 1923 £250,000 of 4½% debenture stock at the price of 87½%. It is redeemable at par in 1962, or at the option of the company on six months' notice at any time after January 1937, at 102½%. This represents a yield of about 5% and is approximately what several British government bonds were then netting the purchaser. The issue was not vigorously pushed, but subscriptions accumulated from conservative investors, and the whole was readily placed in a wide circle of purchasers.

Lower interest rates have been coupled with a public preference for non-speculative securities, and in the latter respect we see some of the same motives operating as in the late nineties. Industrial depression in Great Britain and the slow revival elsewhere have opened opportunities to employ profitably new borrowed capital in acquiring sound securities which have depreciated in value through no internal weakness. The keen discrimination of investment trust directors is more and more being brought into play to distinguish between stocks which have become permanently depreciated, and those of such intrinsic value as to warrant the assurance that their steady appreciation is merely a question of time.

**Financing Companies.**—The chief cause of the higher recent ratio of proprietary capital to be found among British trusts is the combination of factors which has tended to discourage debenture issues since the nineties, and to develop of later years the financing, trading and promoting company to an

equal, or even greater extent than the investment trust. If the former type of company were included in the preceding table, we should notice a considerable organization activity since 1909 and an apparent stimulus lent by the war. The number of companies would be increased by from a hundred to a hundred and fifty. The capital would expand from about £100,000,000 to a total between £250,000,000 and £300,000,000. The ratio of debentures would be further reduced, for the more speculative character of the financing company's business is not generally conducive to a use of the same measure of borrowing power. In Chapter I the outstanding share capital of active financing companies is given as about £110,000,000, and the debentures as £40,000,000, the ratio of the latter being therefore about 35%. If those organized recently were segregated, the proportion of debentures would probably be much lower.

**First Organization Activity During the Seventies.**—It is a matter of record that at least two British investment trusts were organized in the early sixties, but the inception of the movement really dates from the following decade. At the time when the trusts were first organized, it was not anticipated that they would play so important a rôle in the export of British capital and in the establishment of London's financial hegemony. The object was to win for the rank and file of investors a larger return on their capital than could be obtained by purchasing sound domestic issues. At home the bank rate was low, and consols were correspondingly high. In the United States a new era was opening, and in South America the dawn of a great expansion was not far off. Comparatively few men at that time were well enough posted to "play a safe hand" in purchasing from the confusing variety of good, bad and indifferent securities originating overseas, even though legitimate undertakings in new countries could well afford to offer from 4 to 6% above the borrowing rates in the United Kingdom.

Before the resumption of specie payments in the United

States (1879) the pound sterling had commanded over five dollars. When the American government went on record for resumption of the gold standard, the assurance that our money would appreciate further encouraged investment in state, county, school and municipal bonds, public utilities and railways. Many Government issues were for the purpose of aiding rail development. The Municipal Trust Company is one of the trusts organized to buy American municipal bonds, especially in the West and Southwest, at a time when sterling commanded a high rate. On the whole, these financial ventures into the United States proved profitable, despite the fact that many investment trust promoters lived to rue the day when their eagerness for a 10% return overcame their natural reticence to enter the domains of the "carpet bagger" and the prairie wolf. Any student is only too familiar with this period of irresponsible state and municipal borrowing, and the British Corporation of Foreign Bondholders annually reminds us of the defaulted American issues of those days.

It is not surprising that solicitors, accountants and trustees, in guarding and administering estates, should have informed themselves of foreign developments; and that they should have co-operated with bankers and financiers in mobilizing the funds of small investors. The movement probably had its first impulse in Scotland, but it quickly spread to London, and since that time the developments north and south of the Tweed have been generally parallel, except for certain minor differences discussed below.

**The Active Eighties.**—Conditions in the eighties were such as to encourage a rapid development of investment trusts in Great Britain. Domestic money rates were low, and unprecedented expansion in the new world created an insatiable demand for capital. The great contrast in money rates between London and overseas borrowing markets may be visualized



by means of the following figures which are high quotations for Consols during the fifty-year period from 1870 to 1920.

1870 <sup>a</sup> ... 94¾	1881... 103	1891... 97½	1901... 97¾	1911... 82¼
1871... 94	1882... 102½	1892... 96¾	1902... 97¾	1912... 79½
1872... 93¾	1883... 102¾	1893... 98¼	1903 <sup>b</sup> ... 93¾	1913... 75¾
1873... 94	1884... 102¾	1894... 102¼	1904 <sup>c</sup> ... 91½	1914... 77¾
1874... 93¾	1885... 101½	1895... 108¼	1905... 91¾	1915... 68½
1875... 95¾	1886... 102½	1896... 113¾	1906... 91¼	1916... 61¾
1876... 97½	1887... 103¾	1897... 113¾	1907... 87½	1917... 56½
1877... 97½	1888... 103½	1898... 113½	1908... 88½	1918... 63¼
1878... 98	1889 <sup>a</sup> ... 99¼	1899... 111½	1909... 86	1919... 60
1879... 99¾	1890 <sup>b</sup> ... 98¾	1900... 103¼	1910... 83½	1920 <sup>c</sup> ... 52
1880... 100¾				

(Figures are given to the nearest one-fourth)

<sup>a</sup> To 1880, interest was at the rate of 3% per annum.

<sup>b</sup> For the fourteen years from April 1889 to April 1903, the rate has been 2¾%.

<sup>c</sup> The rate has been 2½% since 1903.

The Consols nearly touched par from 1876 to 1879, and for the decade of the eighties they were a shade above, reaching their high point in 1887-1888. The decline in 1889 is more than accounted for by the change of interest rate in that year; and debentures could be issued at this time at such a premium as to net a cost of only 3½ to 4% on borrowed capital. This shows clearly the abundance of capital at home and the need of seeking foreign channels of investment.

**The Baring Crisis, and the "Sobering" Nineties.**—The slight decline in consols from 1890 to 1893 reflects the Baring crisis and the stiff demand for funds which accompanied and followed it. The spectacular rise to a high point of 114 in 1897 may be explained in part by the easing of money rates following the depression, and the temporary demand for a perfectly safe investment following the disturbing events in the business world.

The Baring crisis and the years immediately after it mark a time of great difficulty for the investment trusts. The experience of the First Edinburgh Investment Trust, cited in the preceding chapter, was shared by the better managed ones; but

those which had been more reckless came to grief. In this time of self-searching, many companies realised their mistake in "loading up" too heavily with securities of certain projects, and neglecting the first rule of safety in distributing their risks. Over-zealous directors had been shunting speculative issues, and those which had failed of popular sale, into strong-boxes of their companies. Doubtless many of them sincerely believed that these issues were sound. Certainly the fact that "carpet bagging" bonds of American states, and other questionable paper found so ready an access to the portfolios of many companies reveals an eagerness to net more than the 8% which could be more conservatively earned overseas.

To cite a few illustrations, the Gas, Water and General Trust had involved itself in sugar plantations and a nameless railroad reaching out from New Orleans. Despite the admirable management since its reorganization, it has not yet gained financial strength. A predecessor of the Metropolitan Trust had been used to absorb Argentine provincial government issues which broke disastrously in the Baring crash. When the Metropolitan Trust was founded, the stockholders of the "New Imperial Investment Trust" (itself a reorganization) were offered the option of receiving cash at the rate of £70 for every £100 preferred and £12 for every £100 ordinary, or the equivalent amount of fully-paid shares of £1 par in the new company. In common with many others, the Anglo-American Debenture Company wrote off its heavily depreciated holdings, but by skilful management has at last succeeded in making good the whole loss to its stockholders by building up its reserve, and issuing bonuses.

Following the unhappy experiences of the early nineties, and encouraged by the Verner decision, a number of financing companies altered their articles of association to those of an investment trust,—for instance, the Anglo-American Debenture. Others had by this time outgrown their earlier special interests and lost their more "active" directors. If a quantity of

good securities had accumulated in their portfolios, there were realized the many advantages of limiting activities to investment. The investment trusts on their part became more conservative. Less sanguine people entered their directorates and holdings in any one undertaking were reduced from a maximum of £50,000 to £100,000, to a maximum of £20,000 or £25,000, while the average investment today is probably not a fifth of this. The conservatism of investors in the late nineties made the issue of debentures a feasible policy for trusts whose credit was unimpaired, and this also encouraged greatly their sound expansion.

**Smoother Sailing since 1903.**—The rapid fall in consols since 1900 shadows a rising rate for money, coincident with the great expansion in corporate activity in the two decades before the war. During most of this period American railway and other bonds afforded an investment yielding large margins to the older trusts which had obtained their working capital, either permanently or for long periods, at the lower costs of an earlier era. The newer companies, nevertheless, found greater difficulty in profitably borrowing. Even at the higher rates which less known investment trusts might have been willing to pay, money was not readily forthcoming until they had "proved their metal." Only a few companies incorporated since 1908 have debentures in any quantity outstanding. As a whole the time from 1903 to 1923 did not prove as propitious as earlier periods for organizing new investment trusts, or increasing heavily the debenture commitments of the old. As mentioned earlier, the war seemed rather to have encouraged the speculative and promoting type of company, whose funds are obtained by share capital, until the marked recent activity in investment trust organization.

The reader will see from Appendix B that since 1923 there has been a recrudescence of organizing activity and at the time of writing (fall of 1925) the probabilities are that resumption

of normal conditions in the London money market, economic and political recovery from the effects of the war, and new demands for capital from central and southeastern Europe, Central and South America, the Dominions and the Orient will develop a new phase of active investment trust promotion.

**Scottish and English Investment Trusts.**—The differences between Scottish and English investment trusts are few, and for the most part unimportant. Many of the former are closely connected with London houses (as with Robert Fleming and Company) and several companies of Scottish origin now have their headquarters in London. The Companies Acts are identical for both countries, although the income tax laws as affecting investment trusts have been until recently differently administered in England and Scotland.

Certain Scottish companies keep their offices in Dundee, Aberdeen, Glasgow, or Edinburgh, to save expense. It is amusing to encounter the different points of view of the metropolitan and provincial investment trusts. By the London company a Scottish concern not affiliated with the "City" is regarded as far from the center of things. Scottish trust officials, on the other hand, pride themselves upon having mastered the technique of investment trust management much more thoroughly than their fellows in London. They can support this claim by pointing to such successful companies as the Edinburgh Investment Trusts, the Alliance Trust of Dundee, and the British Assets Trust.

For reasons given in earlier chapters, the terminable debenture is much in vogue in Scotland, although it is used less by English companies, which have borrowed for the most part upon perpetual debentures. A further peculiarity is the growth of the Scottish trusts about the offices of solicitors and accountants. Their evolution seems to have been slower, and not actuated to the same extent by purely business motives on the part of their promoters. The germ of the whole movement



may be traced to the experience gained by Scottish lawyers and trustees in administering large estates.

Notwithstanding their development some hundreds of miles from London, the Scottish trusts have been if anything even more cosmopolitan in their interests than the English companies. The mortgage business of America and Canada has been greatly fostered by many Scottish companies organized for this purpose. A few investment trusts of Scotland still retain in their portfolios some Canadian and American farm and other mortgages. It is in short probable that in proportion to the capital of their undertakings, Scottish investment trust officials have been more active than those of London in making direct contacts with American business men and financiers in search of constructive credits.

**Investment Trusts and British War Finance.**—During the war period British investment trusts could not expand their business, as government loans drove up the rates of interest, and even without the legal limitations imposed upon new issues, patriotic motives would have prevented their competing for new capital. Reasons have been given in Chapter X for the scanty profits made on the sale of their holdings at this time. The trusts were extremely helpful to the government in mobilizing foreign securities acceptable for American credit, and their officials assisted in developing the machinery therefor. Often at a real loss their American investments were sacrificed to enable them to subscribe more liberally to war loans; and when "dollar" securities were not sold they were deposited with the Treasury. But notwithstanding the depreciation of many of their investments, and the sacrifice of others, the trusts as a whole were prosperous even at this time. For the most part their income continued steady, and on that portion of their holdings deposited with the Exchequer, a bonus of  $\frac{1}{2}\%$  was given by the Government. The earnings during this period are discussed fully in the preceding chapter.



**Shifting of Investment Trust Holdings—Reduction of Investments in United States.**—There remain to be pointed out the principal tendencies in the shifting of investments on the part of British trusts during and since the war. The most noticeable tendency has been a proportional reduction in holdings of securities originating in the United States. During the war this was the inevitable result of the exigencies of government finance, but the movement away from dollar investments has been equally noticeable since the war, especially in the period immediately preceding the return of sterling to parity.

Foreign exchange is, of course, always an important factor in interest and dividends as well as original investment. It may occur that larger dividends from common stock of foreign undertakings are partly cancelled by the weakening of exchange on the country concerned, which follows a period of price inflation, and vice versa. Where, as so often happens, securities can be sold after their probationary period in the market where the industry is domiciled, exchange may be the deciding factor. In this case the anticipated rise in sterling led to the selling of dollar securities.

In 1921 for instance the Foreign and Colonial Investment Trust sold nearly £200,000 worth of its securities. Almost half of the sales were of dollar investments. Practically an equivalent amount was purchased in the same year, but not one dollar bond or share appears among them. The Foreign, American and General Investments Trust Company realized on its American holdings in a recent year one-third of the value of its total sales, and bought only two dollar issues from among thirty appearing in its purchase account. The British Investment Trust reported a reduction of its American holdings during 1921, of nearly £250,000 and its chairman stated that "we expect to continue in the same direction to a considerably further extent." The same is true of the American Investment and General Trust Company, about one-half of whose sales in 1921 were of American securities, and whose purchase of

American offerings was negligible. So strong has been this movement that the Robert Fleming interests have almost withdrawn from American securities. At a recent meeting of the Anglo-American Debenture Company it was stated: "Our investments have changed very much since 1914, as we have reduced our American holdings by more than £700,000. Proceeds from these sales have been reinvested in securities, both home and foreign, having higher average yield."

Turning to such classified reports and holdings as are available, we see the same tendency. Below are a few illustrative figures:

PERCENTAGE OF TOTAL INVESTMENTS IN AMERICAN SECURITIES

	Before the War	In 1922
Anglo-American Debenture Co. ....	60-70%	Approx. 25%
Railway Share Trust and Agency Co. ....	"	" "
The Railway Debenture and General Trust Co. ...	"	" "
The Scottish Northern Investment Trust. ....	Over 50%	Approx. 12%
The Second Scottish Northern Investment Trust. .	Approx. 60%	" "

It is probably not far from the truth to say that in 1914 fully 90% of the £75,000,000 to £100,000,000 investment trust capital was sunk in overseas holdings, the United States proving the greatest claimant. To the outbreak of the War probably 30% to 50% of all investments of British trusts were in the United States. As much as a third of these foreign investments were probably mobilized by the British government for war borrowing purposes, and were for the most part subsequently sold. The "unpegging" of sterling in the spring of 1919 introduced further speculative elements into the foreign exchange situation; and the high fluctuating premiums on the dollar during most of the following years has encouraged further liquidation of American holdings. The fact that sterling has now been reestablished at its pre-war parity removes perhaps the greatest deterrent to the placing of American securities

in London, and is now tending to reverse the tendencies discussed above.

**Increased Investment in Latin America.**—Hand in hand with this withdrawal from the United States is appearing a marked increase of interest in Latin America. Britain's investments were heavy in Argentina, Brazil and Chile before the war,—heavier probably than those of any other country, not excluding France. The pressure of British industries for export trade, coupled with the fact that in southern South America we find one of the most promising of politically stable regions, has made a deepening of old associations distinctly profitable. The classified investment lists of the Merchants Trust for 1914 and 1922 illustrate this tendency:

MERCHANTS TRUST  
Distribution of Investments

	1914	1922
Home.....	14.85%	29.59%
Continental.....	2.14	3.55
Colonial.....	10.73	9.22
United States (railways).....	30.95	22.89
United States (miscellaneous).....	19.79	8.08
River Plate.....	9.28	12.47
Other localities.....	12.26	14.20
	100.00%	100.00%

The same is true of the reports of the Industrial and General Trust. Great increases are shown in its domestic holdings, and particularly in its South American interests, while the withdrawal from the United States is equally noticeable, although the percentages for 1925 suggest that this movement has now reached its apex and that opposing tendencies may soon assert themselves.

Exchange is again important in this connection. In terms of sterling the rates for the principal South American cur-

THE INDUSTRIAL AND GENERAL TRUST  
Distribution of Investments

	1914	1920	1921	1922	1925
Great Britain.....	29.26%	39.25%	40.62%	40.09%	38.13%
United States of America.....	23.69	7.92	7.00	6.45	9.05
British Colonies and Dependencies	13.57	14.55	13.02	13.06	12.73
Argentine Republic.....	11.55	15.99	17.22	16.69	13.07
South America, excluding the Argentine Republic.....	8.87	13.46	12.18	13.38	14.35
Mexico and Central America....	5.25	3.24	4.61	4.12	3.44
Europe, excluding Great Britain.	3.22	3.44	2.95	3.40	4.87
Asia and Africa, excluding British Colonies and Dependencies....	4.59	2.15	2.40	2.81	4.36
	100.00%	100.00%	100.00%	100.00%	100.00%

rencies before restoration of the pound to parity had been nearer par than the American dollar. The confidence which most Englishmen have always had that sterling would reach its pre-war gold basis operated much more to discourage purchase of "dollar" than of other securities at not so high a premium. British trusts only dared venture afield when little capital loss was risked from appreciation of sterling.

A further use of their funds withdrawn by British trusts from North American securities has been in sterling issues of domestic corporations engaged in foreign business. Argentine railways are a good illustration of this. Such companies have long been operating, and conditions seem likely to encourage the further development of home registered enterprises engaged in overseas operations.

**Greater Interest in Domestic Issues.**—The heavy purchase of British government issues during the war has shifted somewhat the center of gravity of investment trust portfolios. It will be recalled from Chapter V that in conditions limiting the acquisition of any one type of security, exceptions are frequently found in favor of government loans, but there has been more recently a noticeable tendency to realize on these

holdings, and to return to a broader distribution. Other funds employed in the United Kingdom have gone mainly into preference stocks, but there are good reasons to doubt the permanence of this tendency to transfer investments to domestic offerings.

Illustrative figures for this increased interest in home issues are shown in the last tables. The shifting toward domestic issues during a three-year period is given by the United States Debenture Corporation in its annual reports of 1920, 1921 and 1922. The percentages of its total investments in dollar securities, and in British issues are as follows:

THE UNITED STATES DEBENTURE CORPORATION

	1920	1921	1922
Dollar Securities.....	13.8%	11%	9.7%
British Securities.....	35.6	43	44.1

**Larger Ratio of Prior Lien Securities.**—The war has doubtless resulted in increasing the proportion of prior lien securities held by British investment trusts. Improvement in industrial conditions and in commercial activity, with accompanying higher interest rates, will, for this reason, it is thought in some quarters, adversely affect the market value of important sections of their portfolios, and, in words of the *London Economist* (March 22, 1924), "It will call for great skill to know how and when to avoid this depreciation." It will be recalled in this connection, however, that the greater part of all British investment trust holdings has long been in preferred shares and bonds, while there is no good reason for thinking that substantial improvement in British industrial conditions can permanently have other than a favorable effect upon the market position of prior lien securities.

**Market and Balance-sheet Valuations.**—Despite the very heavy depreciation in market values of their portfolios during



the war and in and after 1920, it is probable that the great majority of investment trusts in Great Britain now enjoy a substantial excess of market over book value of their holdings, and that in most cases even their substantial reserves are fully intact. The fact that the capital of British investment trusts is now for the most part unimpaired<sup>1</sup> is shown in the unusually buoyant market, during 1924 and 1925, for their common shares. It is significant that a compilation by the *London Financial Times* (January 31, 1925), which shows the nominal value of the common shares of thirty-one British investment trusts to be £18,202,000, gave their market value on the London Exchange at the beginning of 1924 as £25,000,000, and at the end of January, 1925, after a year of almost uninterrupted rise, as £31,709,000, every one being at a premium despite the fact that twenty-two of the thirty-one stocks were actually quoted at a discount in early 1919.

**Recapitulation and Conclusions.**—We may now recapitulate certain outstanding features of British investment trusts, as they have been studied in this and the preceding chapters.

**CORPORATE ORGANIZATION.**—The investment trusts of the United Kingdom are for the most part limited companies, chartered under the General Companies Acts. Their capital takes the forms common to corporate organization the world over, and the most successful among them have borrowed extensively by debenture bonds secured through prior subscription of adequate share capital.

**PORTFOLIO MANAGEMENT.**—The debenture bonds issued by British investment trusts are secured by a general lien on the assets of the obligor company. Even where trustees are

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<sup>1</sup> By "unimpaired capital" in this connection is meant a condition in which current quotations on the investment trust's portfolio show the present value of its held securities to be at least equivalent to the par value of all its outstanding capital. "Visible" reserves protect the trusts from actual capital depreciation in this sense, even at times when the balance-sheet valuation may be considerably in excess of actual values (as during the earlier post-war periods of deflation). The "inner" or concealed reserves (Chapters V and VI) for their part operate against the fall of the portfolio's current value to a figure below the valuation appearing in the balance sheet.

appointed, which is not always the case, they do not hold security collateral.

Within limitations largely imposed in the voluntarily drawn articles of agreement of each trust, the directors and management possess the right to follow their own best judgment in altering the composition of the portfolio by buying and selling at favorable times. As far as the writer is aware, there is not one single reputable investment trust in the United Kingdom which immobilizes its investments, imposes arbitrary restraints upon turnover, or prevents substitution of collateral. In fact, profits accruing from turnover or reinvestment are a most important factor in strengthening the reserves of well-managed investment trusts, and a failure to make judicious readjustments in conformity with current market trends would not only fail to capitalize the skill of the trust's managerial staff, but cut off a most important source of strength.

RESERVE ACCUMULATION.—British experience demonstrates the wisdom of building reservoirs between the inlets of net revenue and the outflow of dividends. Moreover, these reservoirs should constantly be enlarged so that the outflow is necessarily smaller, as a rule, than the steady intake. It is dangerous to allow the imagination too free a leap from earnings to dividends, for if the latter are directly geared with the former, there is no opportunity to build a substantial reserve foundation. A trust starting out with the intention of devoting investment income and realized profits on turnover directly and practically entirely to dividends may find itself in periods of business or financial depression like a top-heavy sailboat buffeted by the storms.

The contingent funds or concealed reserves, and the ordinary reserves or surplus of British investment trusts are like balance wheels, or gyroscopic steadiers, enabling them generally to maintain consistent dividend records regardless of changing conditions. These reserves are being constantly added to, and

they are continually increasing the equity behind the common stock, as well as its dividend paying power.

**DISINTERESTED MANAGEMENT.**—The representative investment trusts are not affiliated with banks; nor are they controlled as a contributing side line by issuing houses or brokers. The advantages of independence are the complete discretion vested in their directors to purchase only those securities which will presumably make the best investments, and to participate in underwriting only such issues as would prove a sound and acceptable holding in case it is necessary to take the guaranteed quota. Despite their general independence of issuing houses, the broad interests of their directors and the considerable clientele which they control open to investment trusts many opportunities for profitable participation, and give them an influence in directing investments out of proportion to their own investing power. At the same time, issuing houses enjoy their co-operation without necessarily participating in their organization, or direction.

**LONG EXPERIENCE.**—The better known investment trusts of the United Kingdom were organized for the most part in the late eighties, and the nineties, the former being the period of greater activity. The economic factors encouraging their development in the late eighties were the ease of raising money in England and Scotland on a net yield to the lender of  $3\frac{1}{2}$  to  $4\frac{1}{4}\%$ , and the many opportunities of reinvestment in foreign securities at a yield of from  $5\frac{1}{2}$  to  $8\%$ . Considerable activity in organizing new investment trusts is to be noted in Great Britain in 1924 and 1925, and it is likely that the restoration of political and financial tranquillity on the European Continent will lend further stimulus to this development.

The rise in home interest rates which has accompanied the expansion of corporate activity since 1900 has not been fully compensated by a corresponding rise in returns on conservative foreign investments. The cutting down of this mar-

gin has limited the expansion of debentures so that from 1912 to 1921 there was a marked increase in the relative importance of outstanding share capital as compared with the former. Even at times when issuing debentures was generally profitable the British trusts have shown marked conservatism in increasing these fixed interest liabilities, the total rarely exceeding 100% of the issued share capital.

**FAVORABLE EARNINGS.**—The earnings of most of the British investment trusts have been remarkably steady during the war and post-war periods. An analysis of dividends shows that the average paid during the war period was but slightly under that of the years 1912 to 1914, and that there has been an even better record since the Armistice. This steadiness results from the wise mixture of senior with junior securities in investment trust portfolios, and from the low rates at which a part of their capital has been obtained for long periods.

**CAPITAL ACCOUNTS.**—The capital account of many British trusts revealed a depreciation during the war, and in the years immediately following 1920. This has not noticeably affected earnings for the following reasons:

1. There has been a general recovery of values lately, which has eliminated most of the depreciation and left intact the capital of the great majority of investment trusts.

2. As interest and dividends from its investments constitute the chief source of a British investment trust's distributable income, the dividends paid on its own stock are only indirectly affected by general variations in stock exchange quotations, i.e., only in so far as current income is used to mark off depreciated values, and the fluctuations in security prices affect a trust's opportunities for profitable new investment.

3. Profits made from realization on investments are used to write off such losses, or to build up a concealed reserve maintained by most investment trusts; and this policy gives steadiness to the dividend record.

SKILFUL MANAGEMENT.—The fact that stands out clearly is the skill with which most of the companies in Great Britain have been managed. An alert secretary, board, and staff are essential in the successful operation of any investment trust. This is obviously not an easy condition to fulfil, as those responsible must have not only a working knowledge of investments, but also a familiarity with world economic conditions and needs which is only bred by wide experience and contacts. In fact, investment trust management is at once among the most difficult and interesting occupations in the whole world of finance.



## CHAPTER XII

### CONTINENTAL INSTITUTIONS AKIN TO THE INVESTMENT TRUST

**Characteristically a British Institution.**—It is in England and Scotland that the investment trust, in the strict sense of that term, has reached its fullest development. In no other countries do we find considerable numbers of corporations which, while avoiding banking, financing and issuing activities, exist for the primary or sole purpose of acquiring and managing diversified investments. The principle of division of risk through diversification of holdings is, however, one followed in every country and by a wide variety of companies; while capital for these purposes is commonly raised by the sale of stock and bonds.

**Belgian Investment Trusts of Particular Interest.**—A brief consideration of Continental analogues of the British investment trust will serve to emphasize certain fundamental lines of cleavage marked by the Channel, and ought to prove suggestive in any adaptation of European experience to American needs. In this chapter attention will be chiefly devoted to a description of Belgian agencies resembling investment trusts, not only because the writer has recently enjoyed the personal cooperation of Brussels and Antwerp bankers in his attempt to interpret them, but also because these institutions are of overshadowing importance in Belgian finance. In fact, they fail to be thoroughly typical of developments elsewhere on the Continent only in that their evolution is peculiarly marked in that country.

**Continental Investment Trusts Really Financing Companies.**—In general it may be said that investment trusts to be

found in this and in other Continental countries do a financing rather than a purely investing business. However broad may be the diversification of risk, their portfolios are rather in the nature of participations acquired to control, share control, influence policy, or assist in promotion, of subsidiary or related enterprises. In other words, the investment trust of other European countries resembles the financing company of the United Kingdom (see pages 7 to 10). While asserting control of companies in its orbit, as often happens, by means of minority but solid blocks of shares, the Continental investment trust, if it may be called by that name, resembles the historic American holding company, except that its interests are generally more cosmopolitan, and its participations as well as capital are acquired in quite different ways and for quite different purposes.

**Many Continental Banks in a Sense Investment Trusts.**—At the threshold of our enquiry we are struck by the fact that most of the large Continental banks are in a sense investment trusts. The term “commercial banking” carries the same connotation for England and the United States; but beyond Anglo-Saxon countries, where deposit banking has attained its highest development, there is far less emphasis upon the “liquid” nature of a bank’s underlying loans, or the relative adequacy of its holdings of immediately negotiable paper. The same scrupulous care is not taken to insure the solvency of the institution in face of a possible “run on the bank,” a circumstance partly arising from the lower proportion of deposits payable on demand. Banking practice in England and the United States emphasizes the short-term, mobile loan; and beyond the amount of their capital and surplus, ordinary deposit banks do not as a rule accumulate bond investments unless dull demand for commercial credit encourages purchase of earning assets of longer maturity. By implication, if not by direct inhibition, the national banking law in the United States prohibits the purchase of stocks for

investment, or industrial control, lest the prejudiced viewpoint of the enterpriser should take the place of the dispassionate view of the banker and an agency of mobile credit be anchored too near the sandbanks of permanent commitment. There is no doubt that large commercial banks in the United States are a means toward the concentration of business power in the hands of leading financiers, but they are not themselves the direct agencies of this control.

On the other hand, the history of the great German banks, of certain leading banks of France and Belgium, of the Banca Commerciale in Italy, as well as of its peers in the realm of Italian high finance, is practically synonymous with the founding and expansion of many public utility, metallurgical, and other industries, both foreign and domestic, in which heavy proprietary interests are commonly maintained. These formidable sallies into the field of business are financed by the capital of shareholders, reserves and undistributed profits, and the use of funds deposited by societies and individuals; and they are either directly planned and executed, or left to subsidiary boards of strategy comprising the directorate of associated financing companies and promoting investment trusts. Belgian experience affords excellent illustrations of this.

**The Investment Trust in Belgium.**—A perusal of the latest published reports of a number of great Belgian banks shows at a glance to what an extent they may be regarded as investment trusts, or more strictly, holding and financing companies, seeking a reasonable protection by distribution of risk.

**Portfolio of the Banque D'Outremer.**—The accounts submitted by the directors of the Brussels Banque D'Outremer (Overseas Bank) to the shareholders of that institution in the spring of 1924 emphasize the investment trust character of an important section of the Bank's earning assets. "The statistical tables following" declares that report, "show clearly that we remain faithful to the principle of division of risk for which

we have had occasion only to congratulate ourselves in the past. They disclose at a glance the geographical distribution of the enterprises in which we are interested and the manifold social purposes which they subserve." It will be interesting at this point to reproduce the above-mentioned tables:

BANQUE D'OUTREMER.—Type of enterprise in which the bank is interested :

	Per cent of Total Portfolio
Banks and Financial Institutions.....	14.84
Insurance.....	0.46
Trading Companies.....	8.05
Maritime and River Transport.....	6.16
Railways.....	7.53
Tramways.....	4.57
Collieries.....	6.91
Mines.....	1.53
Petroleum.....	2.22
Construction Industries.....	1.70
Coke.....	3.18
Metallurgical Enterprises.....	12.14
Construction Workshops.....	10.57
Electrical Power.....	7.32
Wireless Telegraphy and Telephony.....	5.58
Textile Manufactories.....	2.58
Sugar Refineries.....	0.53
Colonial Plantations.....	4.05
Miscellaneous.....	0.08
	100.00

#### GEOGRAPHICAL DISTRIBUTION.—

England.....	.27
Belgium.....	54.27
Belgian Congo.....	15.48
China.....	5.43
France.....	3.22
French Colonies.....	.73
Greece.....	.51
Italy.....	.53
Grand Duchy of Luxembourg.....	10.40
Holland.....	4.84
Dutch Colonies.....	1.90
Portuguese Colonies.....	1.48
Russia.....	.94
	100.00

Although the portfolio holdings of the Banque D'Outremer are principally concentrated (to about 80%) in Belgium,

Luxembourg and the Belgian Congo, the industrial distribution is truly remarkable, and the most doctrinaire of British investment trusts might well be content with such a showing, as far at least as division of risk is concerned. That the Bank is not, however, an investment trust in the stricter sense appears from the following considerations.

**SUBSIDIARY COMPANIES.**—In the first place, the relations of the Bank with many, or most, of the enterprises in which it is interested are of a very intimate and direct character. Control is exercised over many related enterprises by competent unified handling of minority stock holdings, while powerful representation is obtained on the directorate of other companies.

**GENERAL BANKING AND FINANCIAL SERVICE.**—In the second place, the Banque D'Outremer renders general banking and financial service to the public, as well as to the enterprises whose securities appear in its portfolio. It accepts deposits, both demand and time; it makes short-term loans; it organizes issuing syndicates and participates in underwriting. It is vigilant in ferreting out profitable opportunities for "buying its way" into enterprises which could suitably move within the ambit of its major promoting activities. It participates in the organization of new companies and builds up enterprises which are financially or technically weak. The Banque D'Outremer is, in other words, a "Banque d'Affaires" as well as a commercial bank in the accepted American sense, as is seen in the following data taken from its report for the year 1924:

During the year 1924, the Bank acquired an interest in the following companies:

- Soieries de Maransart
- La Lampe Electrique Belge
- Chemins de fer vicinaux du Congo
- Société Coloniale d'Electricité
- Chinwangtao Glass Co.
- Société d'Etudes en Ethiopie



It participated in the increase of capital of the following companies:

Société auxiliaire Industrielle et Financière de la Compagnie  
du Chemin de fer du Congo Supérieur aux Grands Lacs  
africains  
Electricité et Traction  
Minerva Motors  
Centrales Electriques des Flandres  
Société des Pétroles au Congo  
Ciments du Congo  
Société Nationale pour l'Etude des Transports aériens  
Tramways et Eclairage Electrique de Shanghai  
Compagnie Foncière du Katanga  
Compagnie Cotonnière Congolaise  
Banque du Congo Belge  
Intertropical-Comfina  
Compagnie Ardennaise de Transports et Messageries Van Gend.

The following issues were made under its direction or with its assistance:

Société auxiliaire Industrielle et Financière de la Compagnie  
du Chemin de fer du Congo Supérieur aux Grands Lacs  
africains  
Tissage La Flandre  
Minerva Motors  
Centrales Electriques des Flandres  
Chinwangtao Glass Co.  
Ciments du Congo  
Papeteries De Ruysscher  
Sucrierie et Raffinerie de Moerbeke-Waes  
Soieries de Maransart  
Compagnie Métallurgique Franco-Belge de Mortagne  
Tramways et Eclairage Electriques de Shanghai  
Compagnie du Congo Belge  
La Lampe Electrique Belge  
Société Ostendaise "Lumière et Force Motrice"  
Intertropical-Comfina

PURELY SHARE CAPITAL.—In the third place, the funds which the Banque D'Outremer employs in its long and short-term industrial and public utility participations are derived

solely from the capital represented by outstanding common stock (nominally without par value), the reserves and undivided profits, and the money deposited by societies and individuals. It does not borrow by issuing funded obligations.

The maintenance of deposit accounts by many affiliated enterprises, as well as the banking public, enables the Bank to make substantial temporary advances to associated undertakings, whose varying needs of this sort might not, except for these close interrelations of many industrial spokes through one financial hub, come strictly within the scope of legitimate short-term banking credit. Thus deposits really constitute a source of further participation in practical undertakings.

From this it must not be inferred, however, that even time deposits are tied up in permanent industrial commitments. On the contrary, a study of the recent balance sheets of the Banque D'Outremer will show that its entire portfolio and "participations" (a term explained below) are but a third greater than its issued capital—Francs 100,000,000 and less than 40% greater than its reserves—Francs 96,000,000. If to the former are added the Bank's holdings of Belgian Government bonds, national and provincial—an item excluded from the portfolio and bringing the entire long-term investments of the Bank to about Francs 180,000,000—it is still evident that the capital and reserves comfortably cover such commitments. Advances to the bank's clients and affiliated companies<sup>1</sup> amounted on December 31, 1923, to about Francs 161,000,000, which, with its cash, its deposits with other banks, and its accounts receivable ("effets à recevoir") more than offset the time and demand deposits disclosed among its liabilities at this date, (Francs 278,000,000).

PORTFOLIO AND "PARTICIPATIONS."—Finally, the portfolio of the Banque D'Outremer and similar Continental banks offers many contrasts with that of the typical investment trust. The

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<sup>1</sup> A list of these companies appears in Appendix H.

reasons are not far to seek when it is remembered that the bank in question acquires securities (other than government issues) in order to share or assume control, whereas the investment trust has in mind a purely investment income.

Thus the Banque D'Outremer often associates itself with the launching of new enterprises by direct subscription to the organization fund or initial capital of the undertaking, before any offering is made to the public. It augments the working capital of "going concerns" by loans which may not be immediately documented in publicly negotiable forms. These latter generally appear in the portfolio as "advances," often referred to as "comptes courants debiteurs" or in similar terms. When such advances have been funded into more negotiable forms, ultimately in the thought, perhaps, of disposing of the latter at a profit, certain items which had earlier appeared as accommodation credits for a clientele of subsidiary or associated enterprises may be transferred to the category of "participations," or "participations et valeurs diverses." When the Bank decides that it wishes to retain, more or less permanently as an investment, its interests in these enterprises, when the progress of the latter or other factors cause the original advances to become entirely embodied in securities quoted on the bourses, and when the Bank is ready to disclose to the public the fact and extent of its interest in these undertakings, the items in question move from the "participations" to the "portfolio" category. The portfolio lists the greater part of negotiable securities held, of a portion of which the Bank may, from time to time, of course, be willing to dispose as it finds occasion for profit taking. The December 31, 1923 balance sheet of the Banque D'Outremer lists securities in the portfolio as valued at Francs 85,000,000, while the figure for "participations et valeurs diverses" stands at Francs 48,000,000.

A further very interesting difference to be noted between the holdings of investment trusts and the earning assets of such institutions as the Banque D'Outremer is that the portfolio of

the latter is wholly comprised of shares of stock, mostly common, no bonds having been held since 1919, whereas the investment trust shows a higher proportion, if not indeed generally a preponderance, of bonds, preferred stocks, and other senior securities.

It is the habit of the Bank to insert in its balance sheets the market value of its portfolio holdings, if this is less than their cost, a practice which, as we have seen, is not typical of the British trusts, whose concealed reserves or contingent funds greatly assist in protecting their capital account. It is stated in the Banque D'Outremer's annual report for 1923 that "Our portfolio comprises a considerable quantity of shares in corporations whose activities are conducted in countries of high exchange. The current quotations for these securities show a substantial rise, which stands in contrast with the conservative evaluations of our balance sheet."

**Compared with Other Belgian Banks.**—The two most important banks of Belgium are the Société Générale and the Banque de Bruxelles.<sup>2</sup> The former is interested in the Banque D'Outremer to the extent of some 10,000 of its 235,000 common shares, and holds stock in many other banks and quasi-investment trusts, both foreign and domestic, as is indicated by the classification of its portfolio given below. The latter has a substantial interest in each of the three institutions which are described in detail below and which afford excellent examples of Belgium's nearest approach to the investment trust. In addition to conducting the same full range of banking and financial service as that offered by the Bank D'Outremer, these two greater banks also resemble it in undertaking what might be termed "financing investment trust" functions.

Like the Banque D'Outremer, the Société Générale distinguishes in its balance sheets between financial participations and

<sup>2</sup> The Mutuelle Mobilière et Immobilière, a bank of the Solvay interests, is rapidly forging ahead in Belgium as a third great power in the financial world. This Bank is referred to in Chapter XIII, in connection with the affiliated "Compagnie Financière Americano Belge."

the portfolio. The term "participations" has in general the meaning ascribed earlier in this chapter; while the portfolio is presented under the two categories of "fonds publics" (investments in government obligations), and "actions de diverses Sociétés" (stocks held in different corporations).

The following table, derived from the *Compte Rendu* and presented to the shareholders at their meeting on February 26, 1924, shows the distribution of the investment portfolio (apart from government obligations) which, it will be noted, consists entirely of stocks:

SOCIÉTÉ GÉNÉRAL DE BELGIQUE.—Portfolio in shares of different corporations:

Railways—Tramways.....	Fr. 34,419,425
Collieries.....	52,838,000
Metallurgical and Engineering Establishments.....	49,326,500
Electrical Enterprises.....	7,294,500
Glass Manufactories.....	16,237,000
Miscellaneous Establishments.....	30,609,100
Banks—Financial Institutions:	
Belgian.....	94,901,900
Foreign.....	23,714,250
Colonial Enterprises.....	47,973,400
Total.....	Fr. 357,314,075

The sum total of the Société Générale's "Participations," "Fonds publics" and "Portefeuille" is approximately Francs 808,000,000, a figure far in excess of the capital contributed by the shareholders and the accumulated reserves. If to the latter amounts, totalling Francs 341,000,000, there is added the outstanding funded debt of about Francs 112,000,000, it becomes evident that the long-term assets of the company exceed the entire capital and reserves by nearly eighty per cent, and must therefore represent, to the extent of over forty percent, an investment of cash deposits. However, half of these long-term earning assets are investments in Belgian Government bonds, so that the portfolio of stocks held, and the total of "participations" are amply covered by the reserves, and the capital contributed by proprietors and bondholders. An exam-



ination of the balance sheets and the "profit and loss" accounts shows that the Société Générale is even more notable as a "Banque d'Affaires" than as an agency of commercial credit and related banking functions.

The Banque de Bruxelles has in its entourage a number of promotive investment trusts which are known wherever public utilities and electrical enterprises have been largely developed by foreign capital. Like the Banque D'Outremer and the Société Générale, it offers the whole gamut of financial service to its related industrial and financing companies, and is able to acquire further interests for itself, in the form of negotiable securities or "participations," at terms not available for the public.

The Banque de Bruxelles resembles the Banque D'Outremer in having no outstanding bonded indebtedness. Its portfolio and "financial participations and diverse claims" are more than covered by its reserves and issued capital. In the former (Francs 162,000,000) will be found but Francs 4,800,000 in bonds. The stock held by the Banque de Bruxelles in the Société Générale de Chemins de fer Économiques constitutes a one-twelfth proprietary interest; that held in the Société Financière de Transports et d'Entreprises Industrielles represents a one-thirteenth interest; and that in the Société Générale Belge d'Entreprises Électriques a one-twenty-fifth of the control. These are concerns coming in for a measure of treatment in subsequent paragraphs, as they represent that different type of Belgian investment trust which does not also qualify as a commercial bank.

If space permitted a résumé of its portfolio, the same broad range of industrial interests would be disclosed, the holdings being also largely in common stock. The Banque de Bruxelles and the Société Générale are two great suns in the universe of Belgian finance, around which revolve numerous satellites and toward whose systems gravitate many industrial and financial companies in the process of more complete assimilation to one or another sphere of influence.

So far attention has been confined to three great Belgian banks. Let us now consider a few Belgian institutions which are of a quite different type, in that they limit themselves to activities characteristic of what has been earlier called the "financing investment trust."

**"Financing Investment Trusts"—Société Financière de Transports et d'Entreprises Industrielles.**—This investment trust is particularly interested in electrical undertakings. The annual report for the year 1923 contains the following observations:

If the different enterprises in which we are particularly interested become annually more firmly established, and their earning capacity progressively increases, the reasons must be sought not only in their own intrinsic worth, but, most of all, in the great rôle which the electrical industry is now playing throughout the world, and in every domain. . . . We, therefore, congratulate ourselves daily in having directed our activity chiefly toward this type of enterprise, before which there opens up so promising a future.

This specialization in the electrical world is abundantly evident in the résumé of the 1923 activities of the Société Financière, which is given in the same report, and is here quoted practically in full:

Subscription to the augmentation of capital for the Banque de Bruxelles, les Tramways et Eclairage Electriques de Shanghai, l'Union d'Electricité de Paris, la Societa Mineraria ed Elettrica del Valdarno, la Société Anonyme des Anciens Etablissements Paul Würth, la Société Intercommunale Belge d'Electricité and les Sociétés d'Electricité du Borinage et du Nord de la Belgique (emissions of both common and preferred stock);

Purchase of shares of la Societa Bolognese di Elettricità, of participating shares in la Société d'Electricité de Rosario and of new common stock in the Compagnies Réunies Gaz et Electricité de Lisbonne, offered to former shareholders.

Subscription to the organization of the Sociétés d'Entreprises Electriques en Pologne and the Internationale d'Energie Hydro-Electrique (ordinary and preferred stock, founders' shares, and to the augmentation of the capital of the latter).

The purchase of common and preferred stock in the Sociedad Estoril.

Payments on stock subscribed for in the Compagnie de Signaux et d'Entreprises Electriques, . . .

Taking founders' shares in the Tramways of Barcelona.

We have, in 1923, participated in underwriting syndicates constituted for the purpose of increasing the capital of the Banque de Bruxelles, . . . the Compagnie Française pour l'exploitation des brevets Thomson-Houston, l'Union d'Electricité, l'Energie Electrique du Nord de la France, la Société algérienne d'Eclairage et de Force, . . . All of these issues were disposed of to the public.

The exact nature and extent of the interests acquired by the Société Financière in 1923 are not given, nor does that institution publish its portfolio, as is generally done in Belgium. In fact, it is significant that the balance-sheet entry is "Portefeuille; fonds publics et participations," no distinction being made between negotiable securities held and the more speculative claims of promotive financing which commonly appear under the title "Participations."

The "Portefeuille: fonds publics et participations" of the Société Financière de Transports et d'Entreprises Industrielles in its balance sheet of December 31, 1923, amounts to a little over Francs 45,000,000, to which should be added, in order to determine the size of its investment portfolio, approximately Francs 9,000,000 invested in Belgian Treasury bonds. This figure is more than covered by the subscribed capital (Francs 33,250,000), the reserves (about Francs 15,000,000), and the net bonded indebtedness (Francs 19,159,500).

**BANKING SERVICES CONFINED TO AFFILIATED ENTERPRISES.**—The Société Financière takes no deposits from the general public. It is not a bank in the ordinarily accepted sense. It does, however, render the complete range of financial services to its affiliated enterprises. It receives deposits from them, makes collections and payments for them, and conducts operations of refunding, converting and augmenting capital.

Considerable sums due the affiliated companies are, therefore, always on hand, while among the "assets" will invariably be found short-term and current loans and advances, mainly unsecured by pledge of collateral, made for the major part of its "Sociétés Patronées." That the Société Financière departs far from the "straight and narrow" path marked out for themselves by the British investment trusts appears from the fact that in its balance sheet for December 31, 1923, the total loans, advances, and accounts receivable from affiliated companies amounted to about 60% of the entire investment portfolio.

TECHNICAL AND ENGINEERING SERVICES FOR AFFILIATED ENTERPRISES.—Offices of associated undertakings, especially those of a public utility character, are to be found at the general headquarters of the Société, whose central engineering staff occasionally assists in the solution of their technical and development problems, and whose business offices often act as purchasing, forwarding and contracting agents. Services of this type rendered to affiliated companies are compensated not only by agreed commissions, but also by the economies and earnings of related enterprises consequent upon efficient business and engineering service.

CONTRASTED WITH BRITISH INVESTMENT TRUSTS.—It would be a mistake to compare too closely these Belgian financing societies with the British investment trusts. Although in some ways "*sui generis*," they might more accurately be compared with the British financing companies, or "financial trusts," differentiated in earlier chapters from the pure form of investment trust so commonly found in the United Kingdom. The Société Financière, for instance, makes no great effort to distribute its risks. Its acquisitions of stock and its "participations" depend entirely upon such opportunities as may develop for the profitable purchase of control, or part control, of enterprises within its main fields of interest. A major source of its profits lies in buying weak and financially "run down" compa-

nies, nursing them back to economic health, and disposing of them at a handsome advance. Its engineering and technical staffs are, therefore, an integral part of its organization. Occasionally, though very rarely, it even operates an enterprise without direct financial interest in it.

Some years ago, for instance, the *Société Financière* purchased control of the Barcelona Tramways for approximately Francs 3,000,000. Its interests were later disposed of for Francs 19,000,000. It now operates the Barcelona Tramways on a service charge for the present owners. In some respects the reader will note the resemblance which companies of this type bear to American public utility holding and operating companies. (See Chapter XIII.)

**FINANCIAL CONNECTIONS.**—The financial ramifications of such institutions as we are now considering are complex in the extreme, and it serves no useful purpose to describe them. A cursory reading of its reports will suffice to emphasize the many connections of the *Société Financière* with banks and other financing companies. The joint proprietary interest which the *Banque de Bruxelles* holds in it has already been mentioned. The *Société Financière*, in its turn, holds a block of stock in the *Banque de Bruxelles*. It is interested in the "*Société Centrale pour l'Industrie Electrique*," and the "*Société Générale d'Entreprises*" of Paris, as well as "*The Electric and Railway Finance Corporation, Ltd.*" of London.

***Société Générale Belge d'Entreprises Electriques*, and *Société Générale de Chemins de Fer Economiques*.**—These organizations are of the same type as the more important *Société Financière*. Like it they raise capital by the emission of bonds and the sale of stock, and their interests are mainly in tramway and electrical enterprises. They are also active promoting and developing companies, equipped with technical staffs. Their permanent capital finds employment in the pur-



chase of securities and "participations." The sums deposited by affiliated and controlled societies are in part loaned again on current account to other affiliates.

The portfolios of both concerns are regularly published, and the holdings, as might be expected, are largely in stock carrying voting power. The interests of the Société Générale Belge d'Entreprises Electriques (as far as the portfolio reveals them) are spread among some thirty-five companies; those of Société Générale de Chemins de Fer Economiques are scattered among approximately fifty-five companies. These affiliated undertakings represent endeavor in many countries, and the holdings of the development companies we have here been considering overlap in many cases. They are also at one in their policy of avoiding embarrassing connections with enterprises manufacturing public utility and electrical equipment, thus confining their efforts to the financial prosperity of the subsidiary or partially controlled utilities upon whose economic success their own earnings are so intimately dependent.

**Belgian Investment Trusts and Financing Companies Typical of Those in Other Continental Countries.**—A study of the methods and organization of such Belgian companies as have been described serves to indicate the main lines of Continental development. The investment trust idea seems to have originated<sup>3</sup> in Belgium and to have been applied in one way or another, in that country and in Switzerland; several decades before the first joint-stock investment trusts were created in Scotland and England. Liquidations, reorganizations, and even failures, have marked the varied course of these undertakings; but most financially powerful European countries today have at least a few companies plying a combined investment and financing business, or, more rarely, confining their activities to the acquisition of securities for

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<sup>3</sup> An interesting article on "The Origin of Investment Trusts," written by Grosvenor Jones, Chief of the Finance and Investment Division of the Bureau of Foreign and Domestic Commerce, will be found in *Commerce Reports* of September 1, 1924.

investment purposes in accordance with principles developed by British experience. In general, there may be noted on the Continent a greater specialization than usually obtains in England, as, for instance, investment primarily in electrical, public utility, or metallurgical securities.

To recapitulate, it may be said that the clearly marked division of labor which runs characteristically through the British financial mechanism, finds expression also in the United Kingdom in the numerous investment trusts concentrating their efforts upon buying and holding desirable investments, and keeping their portfolios in desirable shape by profitable, measured, turnover. In Continental countries, on the other hand, such strictly investment trusts are the exception rather than the rule; and the promotive or financing point of view generally colors the portfolio policies, limits the range of investments, and narrows the basis of risk diversification.

**French Companies Illustrated.**—Mention has been made, in the section dealing with the Société Financière, of certain French financing companies affiliated with it, and pursuing a similar business in the field of electrical enterprises. The Société Centrale pour l'Industrie Électrique, for instance, possesses important interests in the following enterprises: La Compagnie Centrale d'Énergie Électrique, La Société d'Électricité de Rosario, La Compania Hispano-Americana de Electricidad, Les Tramways et Électricité de Constantinople, Les Compagnies Réunies Gaz et Electricité de Lisbonne, La Société d'Électricité et de Mécanique (Procédés Thomson-Houston et Carels), L'Union d'Électricité, La Compagnie Électrique de la Loire et du Centre, and, as well, in the Société Financière de Transports et d'Entreprises Industrielles.

Another French company associated with the Belgian Société Financière is the Société Générale d'Entreprises, Paris. Its activities extend throughout all of France, into the colonies, and into foreign countries. Its extensive projects for electri-

fication, in execution as well as on paper, mark it as essentially a development company.

The *Crédit Mobilier Français* originally conducted purely an investment trust business; but, as with the majority of other Continental financing companies, banks, and investment trusts, its earlier activities have been considerably modified. It is now an issuing house, and does, as well, an extensive business in reorganizing industrial undertakings and banks.

The last named of these Paris companies has raised its capital purely by the sale of stock. The *Société Générale d'Entreprises*, whose balance sheet for June 30, 1924, appears in Appendix D, has a considerable volume of bonds outstanding. Unfortunately, none of these French companies publishes a list of its investments.

**Other Countries—SWITZERLAND.**—Much time could be profitably devoted to the study of Swiss contributions to investment trust technique. In that country, as in Belgium, financing investment trusts have assumed great importance, although there are few peculiarities in Switzerland which warrant additional detailed treatment within the limited scope of the present study.

It is of interest, however, to glance at several Swiss companies which are representative of developments in that country, and which afford good illustration of the means employed by this thrifty little nation in mobilizing and exporting her capital. One of the most interesting financial corporations, whose operations approximate those of an investment trust rather than a financing concern, is the *Société Financière Franco-Suisse*, from whose statutes the following articles are translated:

#### SOCIÉTÉ FINANCIÈRE FRANCO-SUISSE

##### ARTICLE 2

The Company has for its principal purpose the purchase and sale

1. Of obligations of states, cities or communes;

2. Of bonds or notes issued by railway companies enjoying an annual mileage or other guaranty given by a government;
3. Of bonds of land banks and kindred institutions, or of railways, based upon a legally attested mortgage lien. In any case, as regards this last category, investments therein shall not exceed a quarter of the entire investments of the Company. . . .

#### ARTICLE 12

The Company may issue its own obligations at the discretion of its Administrative Council, and in the proportion fixed by them. The funds so obtained shall be utilized exclusively for the purchase of securities of the second category in Article 2, and the latter shall serve as collateral for the service of the loans.

These securities shall accordingly be deposited with banks or credit establishments designated by the Administrative Council as a guaranty for the aforesaid loans and under conditions determined upon at the time of each issue. At the most, the total amount of funded loans may not be greater than 150 per cent of the subscribed capital.

The Société Financière Franco-Suisse has a subscribed capital of Swiss Francs 20,000,000, of which but one-fifth has been called. The bonds (4%) outstanding total Francs 18,000,000. The portfolio consists of government and municipal obligations and public utility and railway bonds representing about fifty different issuers. These circumstances account for the difficulties of the company since 1913, after which year the pre-war dividends of 20% or over (20% in 1911, 22½% in 1912 and 20% in 1913) dwindled to nothing. Added to the natural disadvantages of maintaining exclusively an interest-bearing portfolio during periods of high money rates and credit stringency, have been the further complications of exchange fluctuations and temporary default affecting adversely the yield and market valuation of the Company's heavy holdings in Turkish, Serbian, Bulgarian, and French issues. Commendable steps are now being taken to purchase annually a proportion of the unduly heavy bonded indebtedness, while a great part of the current income has been used in recent years to offset the further decline in market value of investments

held. The Company is now affiliated with the Union Financière de Genève, which is a typical banking and financial corporation.

Like the Société Financière Franco-Suisse, the Société Franco-Suisse pour l'Industrie Electrique has been sensibly affected by exchange fluctuations. At the end of 1923 a sum exceeding Swiss Francs 18,400,000 stood in its exchange depreciation account on the assets side of the balance sheet, despite the fact that its investments showed sufficient international diversification in that year to compensate, in issues of certain currencies, the depreciation in other issues due to adverse exchange fluctuations. As its name indicates, the company operates primarily as a promotive investment trust in the electrical field. Its portfolio is largely in common shares, and represents primarily an interest in ten Swiss and twelve foreign undertakings. In 1923 a capital of Swiss Francs 25,000,000 had been paid in, and a net bonded indebtedness of approximately Francs 32,500,000 was outstanding.

Among the Swiss financing companies and investment trusts there are several whose interests have been more particularly in the United States and Canada. The following is translated from the statutes of the Société Financière pour Entreprises Electriques aux États Unis:

#### ARTICLE 2

The society has for its objects to engage, in all countries, and more especially in the United States, for its own account, for the account of others, or in participation with others, in all operations, affairs or enterprises, commercial, financial or industrial, all enterprises of public utility, and in particular those pertaining to the furnishing of lighting and electrical power.

This Company has been interested in the American and Foreign Power Company (created under the auspices of the Electric Bond and Share Company), and the Pacific Gas and Electric Company; and has had a number of resident directors in New York. The Société Financière Suisse-Américaine is



heavily interested in our country, as the following tables, taken from its report for the calendar year 1923, show:

SOCIÉTÉ FINANCIÈRE SUISSE AMÉRICAINÉ

December 31, 1923

Geographical Distribution of Investments

		% Proportion of Portfolio
North America.....	Swiss Fr. 5,037,500	35.95
Mexico.....	290,602	1.95
Argentine Republic.....	858,000	6.15
Switzerland.....	549,900	3.95
Other.....	7,294,200	52.00
Total.....	14,030,202	100.00

Distribution by Type of Security

	% Proportion of Portfolio
Industrial and other bonds.....	56.95
Railway bonds.....	14.65
Government obligations.....	10.80
Preferred stock.....	6.45
Common stock.....	11.15
	100.00%

The paid-in capital of the Société was at this time Swiss Francs 1,650,000, an amount of Francs 6,600,000 not having been called to this time; whereas bonds outstanding reached the proportionally heavy figure of approximately Francs 12,000,000.

It would be of interest, if space permitted, to classify the financing investment trusts of Switzerland according to the fields of their special interest. There is, for instance, a group interested particularly in industrial participations, such, for example, as the Aktiengesellschaft für Industriewerte, whose portfolio consists of shares in some eleven metallurgical establishments, the same number of companies engaged in the trade in iron and steel products, about a dozen chemical and dye concerns, and a few miscellaneous industries. Several others specialize in investments in certain industries or areas as follows:

		Outstanding Shares	Capital Bonds
(1) Electrical Industries:			
Société Financière Italo-Suisse. . . .	Swiss Fr.	11,348,000	...
"Watt" Aktiengesellschaft für elek- trische Unternehmungen in Glarus		8,538,500	7,000,000
Elektrizitäts-Gesellschaft, Alioth. . .		6,000,000	3,000,000
Banque Pour Entreprises Électriques à Zurich. . . . .		112,783,000	...
"Motor" Société Anonyme pour les Applications de l'Electricité a Baden (Suisse). . . . .		36,000,000	45,000,000
Schweizerische Gesellschaft für elek- trische Industrie in Glarus. . . . .		24,000,000	...
(2) Transportation Enterprises:			
Bank für Transportwerthe, in Glarus	Swiss Fr.	10,000,000	30,000,000
Banque des Chemins de fer Orientaux à Zurich. . . . .		35,000,000	36,749,000
(3) Geographical Areas:			
Société Financière Pour L'Industrie au Mexique. . . . .	Swiss Fr.	7,500,000	...
Société Financière Pour L'Industrie au Canada. . . . .		5,000,000	...
(4) Broad Investment Range:			
Union Financière de Genève. . . . .	Swiss Fr.	12,000,000	...
Schweizerische Gesellschaft für An- lagewerte in Basel. . . . .		5,000,000	24,050,000
Schweizerische Bank für Kapital- anlagen, Zürich. . . . .		7,500,000	11,600,000
Schweizerische Eisenbahnbank. . . . .		10,000,000	20,430,000

GERMANY.—Any student familiar with German banking will not be surprised to learn that investment trusts in the strict sense are of comparatively little importance in that country. The huge expansion of domestic enterprise since 1890 has called for the investment of the greater part of the savings of the German people in their own industries. The dominating position of the great banks and their allied provincial groups has necessarily resulted in the close connections obtaining between them and the controlling and holding companies, and promoting, financing and investing corporations by means of which, in part, they have extended their hold upon the economic life of the nation. Such developments are only natural in those Continental countries experiencing great in-

dustrial expansion; and it is hardly to be expected that foreign financing through the instrumentality of investment trusts or similar companies will take place on a large scale until there exists a comfortable margin of capital for employment elsewhere, and a fair opportunity to use this capital safely, and comparatively profitably, in other lands. This is not a valid reason, however, for failure to develop investment trusts on a large scale primarily for domestic financing.

It should be noted that Germany has had recourse to the investors of Switzerland in raising capital both for foreign and domestic undertakings especially in the field of public utilities. Organization of financing companies, by German initiative and under German leadership and control dates in that country from 1895, when the Bank für Electriche Unternehmungen was organized at Zurich. The backing German interests were mainly represented by the Allgemeine Elektrizitäts Gesellschaft of Berlin, the Deutsche Bank, and the Berliner Handelsgesellschaft. German enterprise in Switzerland also took the form of enlisting the co-operation of Swiss institutions, which, like the Crédit Suisse, assumed nominal leadership. Other illustrations might be given of this means of extending influence by foreign financial devices, as, for instance, the organization in 1896 of the Schweizerische Gesellschaft für Electriche Industrie, by the German Siemens Halske A. G.; while those who have followed the absorbing story of Italian industrial progress in the days since the Risorgimento know to what an extent German capital, organizing genius, and control manifested itself in pre-war days. It has been said that the Banca Commerciale Italiana, greatest of Italian banks, and heavily interested in large-scale industry of that country, was developed to a considerable extent by German brain and leadership. It is now, however, a thoroughly Italian institution.

## CHAPTER XIII

### AMERICAN FINANCING COMPANIES

**Cardinal Principles of the Investment Trust Long Applied.**—In limiting the scope of the present volume by offering a concise definition of the "Investment Trust," the following characteristics were dwelt upon in Chapter I: (a) the raising of capital by sale of shares, or of shares and bonds, for the purpose of investment in (b) so widely diversified a list of securities that (c) the different holdings do not represent participation in management and (d) the composition of the portfolio may be altered in part or in whole as circumstances warrant. Each of these basic principles is familiar to us in the United States in numerous forms. It is only the combination of them all in the investment trust which is a comparatively recent development.

**Diversification of Risk.**—Illustrations will occur to the reader of the application of principles of risk diversification in a variety of American institutions. The majority of our commercial banks are not permitted to purchase stocks,<sup>1</sup> but they do invest large sums in bonds, notes and warrants, very frequently with a considerable spreading of risk. Savings banks and trust companies, the latter particularly in connection with the management of estates and the care of trust funds, gain security not only in acquiring investments of the types specified in regulatory laws, but also in effecting variety within this narrower range of choice. Insurance companies in every field have been referred to, on occasion, as quasi-investment trusts. It is of interest to know, by way of illustra-

<sup>1</sup> Under the National Banking Act, national banks are not permitted to make such purchases and standards of state laws tend to conform to the national.

tion, that the Home Insurance Company, one of the larger undertakings in the field of fire insurance, has investments consisting of issues of more than three hundred corporations, governments, municipalities, or provinces, with a market value at the end of 1924 exceeding \$70,000,000. The assets of most, if not all, insurance companies consist for the greater part of their outside investments, and the dividends payable upon their shares, or profits distributed to policyholders in mutual companies, are dependent in large measure upon the skill and care with which their capital and premium income are invested and reinvested. The fact that in many jurisdictions the investments of insurance companies are regulated by law is a disadvantage, as compared with the investment trust, under which they conduct this part of their business; while an examination of the investments of American insurance companies, mainly in mortgages, mortgage bonds and loans to policyholders, suggests the greater flexibility, distribution and yield of the larger part of a typical investment trust's holdings.

Whether secured by deposits, trusteeships, or premiums for insurance, the money of the American public has been for many decades the more safely employed by diversification in investment, made possible through combining capital of the many under different forms and for different purposes.

**Raising Funds for Reinvestment.**—Many examples might be cited illustrating application in the United States of other investment trust principles. Particularly by means of real estate and farm mortgage companies, the public has become familiar with the practice of raising capital for purposes of reinvestment. Many of these are more than intermediaries in the placing and distribution of mortgages. They also sell their own bonds, securing them by the deposit of purchased mortgages with trust companies, which thus guard the interests of the new creditors. This means of placing mortgage loans through public subscription has been popularized during recent



years by the offer of bonds of smaller denomination and of coupon notes of convenient amounts and maturities.

Application of the investment trust principle to short-term credit operations is illustrated by "Commercial Investment Trust Corporation" of New York. Cumulative First Preferred Stock bearing 7% has been issued, as well as a large block of common without par value. "The corporation's consolidated assets consist almost entirely of cash and receivables which are constantly liquidating into cash." (Quoted from prospectus.) Also, "The business in large part consists of financing manufacturers and merchants by purchasing evidences of indebtedness arising from the sale of a large variety of nationally marketed products such as automobiles, electrical appliances and machinery. A large portion of the transactions differ from the usual bank loan or discount in that they represent the purchase of obligations resulting from the completed sale of merchandise for moderate amounts to a large number of purchasers throughout the United States."

The term "consolidated assets" is used at the beginning of the above quotation to designate the assets of certain subsidiaries, especially the "Commercial Investment Trust, Incorporated," whose stock the "Commercial Investment Trust Corporation" was really formed to acquire and to hold. The latter, being, therefore, technically a holding company, is organized under the general incorporation laws of the state of Delaware; while the former, which does approximately 90% of the present business of the Corporation, operates under the Investment Section of the New York State Banking Law. Other subsidiaries are the Canadian Acceptance Corporation, Ltd., and the Mercantile Acceptance Company. The reader will think of other similar discount and commercial credit companies for which the rapid development of installment purchasing in the United States is creating so wide a field of operation.

"In theory," says Elisha M. Friedman, in his "International

Finance and Its Reorganization," "the War Finance Corporation operated like the European investment trusts. It took the obligations of the American exporter, backed by the paper of the European importer, endorsed by his bank and guaranteed by his government. On the other hand the corporation expected to obtain additional funds through the sale of its own debentures, the first series of which amounted to \$200 million, and were issued in 1919 (though not under the amendment authorizing the promotion of exports)."

**Agricultural Credit Institutions.**—So important is the problem of agricultural credit that several American states, as well as the Federal government, have sought to extend the application of these methods of raising long-term capital by providing greater security to the investor and thereby broadening the potential market for farm mortgage debentures. Tentative plans have been proposed during recent months for the organization of an American corporation which would broaden the market in this country for German mortgage bonds on farm property, particularly for the obligations of the Rentenbank, which is now largely a land mortgage institution, by purchasing the same, and either reselling them or issuing bonds specifically secured by such collateral as well as the capital and surplus of the American company. A number of commonwealths have enacted laws permitting the establishment, under peculiarly favorable circumstances, of co-operative loan associations not unlike those operating within the Federal Farm Loan system. Provision has furthermore been made for the creation of land banks, under theegis of the states, whose stock is held by these associations. The latter grant loans to their members upon the proper execution of the mortgages, and redeposit these with the land banks, which are at liberty to make partial use of the credit of the state by issuing their own bonds secured by deposit of the original mortgages with the state comptroller, or a similar designated officer.

MORTGAGE BONDS OF FEDERAL FARM LOAN SYSTEM.—Between the quasi-co-operative farm loan systems to be found in several American states and the Federal Farm Loan system are differences rather of detail than of principle. The twelve Federal institutions, modelled in certain respects after the Federal Reserve banks, and acting under the general control of the Federal Farm Loan Board, have raised over \$600,000,000 for agricultural borrowers by marketing their "farm loan bonds," which are debentures secured by the deposit of acceptable mortgages with the Farm Loan Registrar of the district. These mortgages are negotiated at first by "national farm loan associations," which are co-operative local groups of farmers organized for the purpose of opening conduits to the capital reservoirs of the Federal banks.

In his "Financial Organization of Society," Harold G. Moulton says:

The bonds that are issued against the farm mortgages as collateral are the direct obligation not only of the Federal Land bank that issues it but of the entire twelve land banks jointly. Since the investments of these banks necessarily consist primarily of real-estate mortgages and since, for the system as a whole, these mortgages are drawn from every part of the country, it will be seen that the risks of the Federal Land bank system are very widely distributed. The law also provides that of the capital of the Federal Land banks for which stock is outstanding in the name of farm loan associations, 25 per cent must be held as quick assets, in the form of cash in vault, deposits in member banks of the Federal Reserve System, or in readily marketable securities approved by the Federal Farm Loan Board. Of these, not less than 5 per cent must be United States government bonds. Each Federal Land bank, given conservative management in conformity with the law, is therefore practically certain to be in position to meet its obligations as they mature. Certainly there would appear to be little chance that the system as a whole would not be able to meet its obligations in full.

It will be noted that the Federal Farm Loan Registrar bears the same relationship to the issuance of Farm Loan bonds as the

Federal Reserve Agent does to that of the Federal Reserve notes.

There are also some sixty "Joint Stock Land Banks" working under Federal charter. These are private institutions, although their debenture bonds are similarly secured by the deposit of mortgage collateral with the Federal Farm Loan Registrar. Their bonds are engraved by the United States Treasury Department, as are those of the Federal Farm Loan banks, but in form and color they are quite distinct. The total debenture bond issues of the privately owned Joint Stock Land banks may not exceed fifteen times the amount of capital stock. The limit is twenty times with the Federal Land banks.

**PUBLIC UTILITY FINANCING.**—It is in the field of public utility financing that the American public is perhaps most familiar with the many means of providing capital through issuing, promoting, controlling and holding companies. The above-mentioned methods utilized for providing long-term agricultural credit find their counterpart, for instance, in corporations selling their own bonds secured by hypothecated public utility securities.

The Electrical Securities Corporation, for instance, a subsidiary of the General Electric Company, has from time to time issued series of Collateral Trust Sinking Fund Bonds, secured by collateral of public utility securities. In all, twenty such series have been issued, with an aggregate principal amount of \$15,500,000. The Corporation has outstanding \$1,000,000 in 5% Cumulative Preferred stock, and \$2,500,000 Common stock, all owned by the General Electric Company.

The International Power Securities Corporation (formerly the Italian Power Company), a company chartered in Delaware in 1923 with an authorized and subscribed capital of \$5,000,000, has offered in the American market several issues of this sort, namely:

\$2,000,000 in 6½% Collateral Trust Gold Bonds maturing in 1928 and secured by an equal amount of acceptances of the Edison Electric Company of Milan, bearing the same interest and maturity.

\$10,000,000 in 6½% Secured Gold Bonds, secured by \$10,000,000 Closed First Mortgage on all Hydro Electric plants of Edison General Italian Electric Company, Milan. Due in 1955.

\$4,000,000 in 6½% thirty-year Collateral Trust Gold Bonds secured by a like amount of External Gold Bonds of the Union d'Electricité, Paris, bearing the same rate and carrying the same maturity.

\$5,000,000 in Ten Year 7% Secured Gold Bonds, due 1936, secured by an obligation of the Italian Gas Company, Turin, and carrying stock purchase warrants in the latter.

It is the object of the corporation "primarily to acquire after careful investigation securities and obligations of leading electric light and power companies operating in the United States and foreign countries." There is no doubt that such methods of finance will be increasingly applied at home and abroad, to the direct advantage of American trade and in the interest of a broader international distribution of American capital.

The raising of funded capital by the hypothecation of securities, or other money claims, and the investment in bonds, stocks and mortgages of funds obtained by the sale of shares are, therefore, of common application in America. Such undertakings as we have just been discussing, however, lack, among other characteristics of the investment trust, the spreading of risk, which is the very foundation of investment trust polity.

It is of interest to observe that the Italians are themselves resorting more and more to these methods of raising capital in the domestic market for the financing, particularly, of hydro-electric developments. A kind of Italian equivalent of the



International Power Securities Corporation is the *Istituto di Credito per le Imprese di Pubblica Utilità* (Credit Institution for Public Utility Enterprises), organized in 1924 with headquarters in Rome. The capital of the latter (paper Lire 100,000,000) has been largely raised by subscriptions of national savings banks, insurance offices and public loan agencies; and the first emission of collateral trust bonds ("obbligazioni ipotecarie") was made in the spring of 1925 for an amount of Lire 150,000,000, bearing interest at 6%, and to be amortized within thirty years. These bonds have a par value of Lire 500 and were offered to the public at Lire 477.50 by a syndicate composed of all the greatest commercial and savings banks of Italy. This first funded borrowing of the *Istituto di Credito* corresponds in amount to sums loaned to the following hydro-electric and public utility enterprises: *Società Imprese Elettriche Conti*; *Società Idroelettrica Veneta*; and the *Società per l'Industria e l'Elettricità "Terni."* The aforesaid bonds therefore are protected by the mortgage liens held by the Istituto upon the plants of the debtor companies, but also by the capital and reserves of the issuer, whose unconditional obligations they are. To assure adequate protection in lending operations, the Istituto advances, at the most, 50% of the value of the mortgaged plants, and interest on, and amortization of, its own obligations proceeds *pari passu* with payments of the debtor public utility enterprises. The bonds of the Istituto are classed among those upon which the Banks of Emission are authorized to make loans, and are regarded as gilt-edged investments in Italy.

**Holding Companies.**—A greater diversification is frequently found among American holding companies, which were for a time in the United States the characteristic vehicle of business combination. They accomplished their aims of wielding central control over the affairs of formerly competing companies, not only by exchanging their shares (and occasion-

ally their bonds) for the shares of other corporations, but also by purchasing outright such shares and financing these acquisitions through the placing of their own bonds or stock on the market. The most important holding companies now to be found in the United States are in the public utilities field. Many of these own power and light companies serving a considerable geographical area, and are active financing and operating enterprises rather than mere agencies of group control.

In fact, the growth of public utility financing and managing companies forms one of the most absorbing chapters in American financial history. In expanding its sphere of influence, many a holding company has acquired subsidiary undertakings in regions so diversified in climate, population, industries and resources as to lend stability to the joint enterprise, and facilitate the raising of capital in the nation's chief money markets. Furthermore, economies of large-scale buying, and of highly competent technical direction, have thus, through these vast co-operative endeavors, extended cosmopolitan services to outlying communities.

Illustrations might be cited covering the entire vast network of electric and gas, power and light, services in the United States, but the reader will at once think of such representative holding and managing companies as the following:

The Utilities Power and Light Corporation owns systems operating in Rhode Island and New Jersey and four middle western states, among them being the Interstate Power Company and the Eastern New Jersey Power Company.

The United Light and Power Company carries this announcement of its history and business in a recent prospectus:

The history of the business now carried on by The United Light and Power Company has been one of steady growth and progress for the fifteen years since its inception. The predecessor Company, absorbed by The United Light and Power Company, at its inception (in

1910) controlled public utility companies with Gross Earnings of only \$861,600, which earnings have since grown to exceed \$35,407,000, for the twelve months ended June 30, 1925. The communities served by the combined properties total 289 and include such important cities as Kansas City, Mo.; Columbus, O.; Davenport, Iowa City, Cedar Rapids, Ottumwa, Fort Dodge and Mason City, Iowa; Lincoln, Neb.; Rock Island and Moline, Ill.; Chattanooga, Tenn.; and La Porte, Ind. The aggregate population served is in excess of 1,750,000 and of the combined Gross Earnings over 80% is derived from the sale of electric light and power, manufactured gas, and from miscellaneous sources, including the sale of gas and electric appliances. Among the principal companies controlled by The United Light and Power Company are Kansas City Power and Light Company and The Columbus Railway, Power and Light Company (Subsidiaries of Continental Gas & Electric Corporation) and The Tri-City Railway and Light Company.

The properties of Continental Gas & Electric Corporation and its Subsidiaries were added to The United Light and Power Company's system in 1924 and have increased the facilities of the system to the following aggregates: 330,000 K.W. of electric generating capacity, 2,436 miles of transmission lines, over 6,230 miles of distribution circuits, 18 gas plants, 931 miles of gas mains, 368 miles of street railway and interurban track and over 450 passenger and freight cars.

The Associated Gas and Electric Company, a New York corporation, controls directly or through its affiliated or subsidiary companies, including the Pennsylvania Electric Corporation, systems in eleven eastern states and the City of Manila. The total investment in these operating properties, which are supervised by the J. G. White Management Corporation, is estimated at \$175,000,000 or more, and the company states that "The geographical distribution of these properties and the diversity in urban and semi-rural business are significant factors of stability."

The National Public Service Corporation has as its most important subsidiary the Jersey Central Power and Light Company, itself an earlier merger of several public utilities. The corporation controls four other systems and in all serves about one hundred and eighty communities in Pennsylvania, New Jersey, North Carolina, and Florida.

The Middle West Utilities Company, a holding corporation organized under the laws of Delaware, affords another excellent example of intercorporate merging of control. It owns the Central and Southwest Utilities Company, a holding corporation organized under the laws of Delaware which in turn is to hold a large proportion of the common shares of the Public Service Company of Oklahoma, the Chickasha Gas and Electric Company of Oklahoma, the American Public Service Company, the Central Power and Light Company, and the Southwestern Securities Company. The latter has majority holdings in the Southwestern Gas and Electric Company.

Cities Service Company directly or indirectly owns a majority of common stock in more than sixty public utilities (electric light and power, gas, heat, water, ice and street railways), and more than forty companies engaged in oil production, refining, transportation and marketing.

**Acquisition of Foreign Interests by the Public Utility Holding Company.**—In view of the surprising development of public utility holding companies in the United States, it is not strange that several have been created for the purpose of operating systems in foreign fields. Among them is the American and Foreign Power Company, Inc., organized as a Maine corporation on December 19, 1923, and showing the following balance sheet on December 31, 1924:

#### ASSETS

Investments.....		\$48,865,432.05
Current Assets:		
Cash.....	\$	746,611.20
Notes and Loans Receivable.....		115,000.00
Accounts Receivable.....		96,569.50
Prepaid Taxes.....		15,645.17
Total.....		973,825.87
(Uncalled balance on 143,269 shares of Preferred Stock \$13,753,873.80 not included in assets or liabilities—see contra below)		
Investigations.....		59,302.86
Total.....		\$49,898,560.78

## LIABILITIES

Capital Stock (no par value) .....		\$46,735,766.74
Represented by 256,731 Shares of Preferred Stock, 120,000 Shares of Second Preferred Stock and 920,000 Shares of Common Stock (To be issued— 143,269 shares of Preferred Stock upon the payment of \$13,753,873.80—see contra above)		
Current Liabilities:		
Dividends Declared (Payable Jan. 2, 1925) .....	\$ 425,439.03	
Notes and Loans Payable.....	1,079,000.00	
Accounts Payable.....	435,354.53	
Accrued Accounts Payable.....	240,749.79	
Total.....		2,180,543.35
Reserves.....		166,609.54
Surplus.....		815,641.15
Total.....		<u>\$49,898,560.78</u>

The item "Investments" represents for the most part holdings in foreign subsidiary power and light companies operating mainly in Panama, Guatemala, Cuba and Ecuador. The companies controlled, directly or indirectly, by the American and Foreign Power Company are as follows:

## Panama Power &amp; Light Corporation

Compania Panameña de Fuerza y Luz

Panama Electric Company

Compania Panameña de Telefonos

## Empresa Guatemalteca de Electricidad, Inc.

Empresa Electrica de Guatemala

Compania Cubana de Electricidad, Inc.

Compania Cubana de Electricidad, S. A.

Compania de Electricidad de Cardenas, S. A.

Compania Electrica de Cienfuegos, S. A.

Compania de Servicios Publicos "Madrazo," S. A.

Compania Electrica de Alumbrado y Traccion de Santiago

Oriente Interurban Electric Company, Inc.

Compania Cubana de Hielo, S. A.

Camaguey Electric Company, S. A.

Compania Electrica Oriente, S. A.

Guantanamo Electric Company

Compania de Servicios Publicos de Matanzas, S. A.



Compania Hidro Electrica de Matanzas, S. A.  
Compania de Electricidad de Sagua la Grande, S. A.

Several of the properties represented in the above list were acquired, prior to the organization of the American and Foreign Power Company, by the Electric Bond and Share Company, which made several purchases at favorable exchange rates and anticipated a development of power and light business in Central America without the restrictions of increasing public regulation. The Electric Bond and Share Company which owns or supervises groups including fully a hundred or more subsidiary public utility and related enterprises, created the American and Foreign Power Company for the purpose of managing these Central American interests, and holds a majority of its voting stock, the second preferred stock referred to in the balance sheet reproduced above being practically entirely owned by the parent company.

Also in the related fields of public utility manufacture the American financing and holding company has a foothold in foreign countries. A good example is the International Western Electric Company, recently sold to the International Telephone and Telegraph Company. Among the former's associated foreign companies are over twenty foreign manufacturing enterprises in as many different countries.

**"Financing Investment Trusts" Defined.**—Within the broader category of "financing companies" we may now perhaps, without being too academic, distinguish a type to be known as "the financing investment trust." We have seen that the International Power Securities Corporation, a financing company and therefore possessing the characteristic (a) of the investment trust given at the outset of this chapter, does not have the diversification in portfolio, and the other characteristics there posited. The public utility holding companies do, many of them, show characteristics (a) and (b), that is, they are financing as well as operating companies enjoying consider-

able diversification in their investments. They do not, however, possess characteristic (c), for they control their many subsidiary enterprises, or are at least intimately concerned with their direction. Such financing companies partake in part of the nature of the investment trust; and especially as there may arise in the United States investment trusts of a hybrid character, combining a great deal of investment with a certain amount of financing, it may be wise to distinguish a species of investment trust, or a quasi-investment trust, within the great family of the promoting, holding, financing and operating company.

A "financing investment trust" may be defined as a company whose capital, raised mostly by the sale of shares and bonds, or of shares alone, is used to a considerable extent in financing enterprise by acquiring appreciable, if not controlling, interests in various business undertakings; but which seeks to minimize risk by a reasonably wide distribution of these interests. As contrasted with the "investment trust" in the narrower sense, the "financing investment trust," or "financing company," is intimately concerned with the success or failure of various fabricating or trading companies in which it has taken a participation, whether by purchase of shares, by direct extension of credit, or by other means. The investment of its capital results, in the eyes of its managers, in substantial claims to business profits of certain enterprises which it is particularly interested in promoting, rather than in broadly diffused rights to interest and dividends in a great number of undertakings over which no control is exerted and with which no intimate relations subsist. Hence an alternative title of "promoting investment trusts," for with companies of this kind the point of view in investment is rather potential earning power under active new management than past dividend record or present market standing. The term "Continental investment trust" might also be employed, as practically all investment trusts on the Continent are of the financing type. Further than this it is not

feasible to carry the distinction, for variations are many in organization and polity, and it is sufficient to be able to allocate any company as belonging approximately to one or another of these two broad groups.<sup>2</sup>

ELECTRIC INVESTORS, INCORPORATED.—Reverting again to the General Electric, and Electric Bond and Share Corporation family, it may be of interest to note another subsidiary of the latter which more closely approaches the investment trust than any of the foregoing, namely, the Electric Investors, Incorporated. The following statement of its purposes is taken from a recent prospectus :

Electric Investors Inc. was organized under the laws of the State of Maine in September, 1924, and on December 1, 1924, was consolidated with the Electrical Utilities Corporation which had been doing a similar business since 1909.

The main purpose for which the Company was organized is to acquire and hold securities of public utility companies as diversified permanent investments. In addition, it has holdings in the securities of a number of other corporations. The revenue of the Company is principally derived from dividends and interest received from securities owned. The Company has also received income from underwritings and from profits realized from the sale of certain of its holdings.

The Company's largest holdings include securities of the following prominent utility companies, a number of which are supervised by the Electric Bond and Share Company:

American Gas and Electric Company	Consolidated Gas, Electric Light &
American & Foreign Power Co. Inc.	Power Company of Baltimore
American Power & Light Company	Daido Denryoku Kabushiki Kaisha
American Superpower Corporation	(Japan)
American Water Works & Electric	Electric Power & Light Corporation
Co. Inc.	International Telephone & Telegraph
Carolina Power & Light Company	Co.
Columbia Gas & Electric Company	Lehigh Power Securities Corporation
Commonwealth Power Corporation	Middle West Utilities Company

<sup>2</sup> The definition of the "stock conversion company" is left to the next chapter. This is easily distinguished from either of the other types because of the fact that it is in no way an active company and represents merely an issue of participating shares against stocks in a selected list of companies irrevocably deposited with a trustee.

National Power & Light Company	Southeastern Power & Light Company
New England Telephone & Telegraph Co.	Southern California Edison Company
New Orleans Public Service Inc.	United Gas & Electric Corporation
North American Company	United Light & Power Company
Northern States Power Company	Western Power Corporation
Pacific Gas & Electric Company	
Public Service Corp. of New Jersey	

The Company also has holdings in other utility companies and in a number of other corporations, including Irving Bank-Columbia Trust Company, General Electric Company and Union Carbide and Carbon Corporation.

The investments listed above are in many of the most representative and thoroughly seasoned utility companies, covering practically every section of this country. The total population served by the American companies is estimated to be in excess of 36,000,000. Gross earnings of these companies for the past year totaled about \$700,000,000. The territorial distribution of investment is unusually wide as the American companies listed above derive their income from operations in no less than forty-four of the forty-eight states. The corporate distribution of investment is also unusual, almost every type of public utility company being represented in the above list. Thus the factor of diversity of risk is exceptional. The industrialized eastern sections of the country are served by American Gas and Electric Company, Lehigh Power Securities Corporation, Public Service Corporation of New Jersey and New England Telephone & Telegraph Company. Southern states which border on greatly increasing industrial activity, are served by Carolina Power & Light Company, National Power & Light Company, Southeastern Power & Light Company and New Orleans Public Service Inc. Much of the Middle West with its great diversity of manufacturing interest and agricultural importance is provided with its electric service by Commonwealth Power Corporation, Middle West Utilities Company, North American Company, Northern States Power Company and United Light & Power Company. American Power & Light Company and Electric Power & Light Corporation have properties in the fast growing Southwest and the West, while the most important sections of California are served by Pacific Gas & Electric Company, Southern California Edison Company and Western Power Corporation.

Electric Investors has no funded debt, its present capital con-



sisting of 32,395 shares of cumulative preferred paying \$7 annually, 50,000 shares of cumulative preferred yielding \$6 annually, 260,262 shares of common stock, also without par value, and subscription receipts for 514,749 further shares of common, on which a payment of at least ten per cent of the subscription price has been made. Voting power rests in the common stock, and further profits of promotion are reserved by means of option warrants, outstanding to the extent of 25,000 shares of common, and permitting purchase of the latter at \$20 per share.

**THE AMERICAN SUPERPOWER CORPORATION.**—Among undertakings properly to be classified as financing investment trusts is the American Superpower Corporation. This was organized as a Delaware corporation on October 26, 1923, with broad powers "to acquire and hold securities of electric power and light companies, to construct, operate or lease power stations and transmission lines, and to act as fiscal agent for electric power and light properties." A recent prospectus thus describes the activities and sources of income of the Corporation:

The Corporation has acquired as diversified permanent investments common stocks of a number of successful and progressive companies in the electric light and power business. The primary source of its earnings is the dividends on these stocks. In addition, it has received fees in connection with the underwriting of offerings of additional stocks of certain of the companies in which it is interested, and has sold at substantial profits certain of its holdings. The company is fundamentally interested in the development of the electric power and light industry as a whole, and is particularly interested in the development through interconnection of large power systems, along so-called "superpower" lines. It does not aim, however, to control or operate any of the companies in which it has an interest.

The common stocks held by the American Superpower Corporation represent an interest in nineteen public utility undertakings, including the Electric Bond and Share Securities Corporation. The policy has been adopted of owning no more than



15% at most, of the outstanding common stock of any one company.

Capitalization of the corporation, in October, 1925, was as follows:

	Authorized	Outstanding
First preferred stock (no par value) (cumulative dividend of 6%).....	100,000 shs.	80,000 shs.
Participating preferred stock (par value \$25).....	300,000 "	140,000 "
Common stock (no par value) Class A.....	600,000 "	189,000 "
Common stock (no par value) Class B.....	750,000 "	490,138 "

There is no funded or floating debt, the net assets at current market prices exceeding \$27,000,000.

The difference between Class "A" and Class "B" common stock lies in the fact that the latter possesses the sole voting power. To the original subscribers were issued approximately 260,000 option warrants carrying rights for subscription to a like number of Class "B" common stock at \$10 per share. Expenses of operation being low, by reason of the fact that this is an investing rather than an operating company, it has been estimated that earnings for 1925 will exceed \$4 per share on the "A" and "B" stocks. Dividends at the rate of 60¢ annually were paid on these stocks in 1924, and the annual distribution was raised to \$1.50 in 1925. These dividends are payable in participating preferred stock, at par, and are therefore not subject to Federal income tax. An extra dividend of \$1 per share on the latter stock has recently been declared, "as this issue participates to the extent of \$1 extra in any year that the common shares receive \$1 or more."

The GENERAL PUBLIC SERVICE CORPORATION, organized under the laws of Delaware in December, 1925, affords further illustration of the "financing investment trust." Directly, or through its control of the Public Service Investment Company, the Corporation has an interest in ten or more widely scattered public utility companies.

The AMERICAN STATES SECURITIES CORPORATION might also be cited as a "financing investment trust." A Delaware

Corporation, it is authorized to invest in, and buy and sell securities of public utility corporations and allied companies. Substantial equities are owned in ten or more public utility holding or operating companies. Capital has been provided by issuance of Class A and Class B no par stock, the latter enjoying sole voting power.

**NORTH AMERICAN UTILITY SECURITIES CORPORATION.**—Another illustration of the type of company which may be referred to as a financing investment trust is the North American Utility Securities Corporation, which was incorporated in Maryland in December, 1924, to “participate in financing and development of public utility and other enterprises in America and abroad.” As its name might suggest, the corporation is sponsored by the North American Company, which pays \$6,000,000 in cash for some 60,000 shares (exactly 50%) of the second preferred stock, and 400,000 shares (of the total of 1,000,000) in common stock. Both common and preferred are without par value, and the first issue to the public was in 100,000 shares of first preferred, bearing cumulative dividends of 6% and carrying no voting power. The reason for the organization of this subsidiary by the North American Company has been stated as the desire to take advantage of opportunities afforded to the company and its associated banking interests, to employ capital profitably in other enterprises than its affiliated undertakings.<sup>3</sup>

Finally, it is very interesting to observe that the development of “financing investment trusts” in America is not confined to the public utility industries. In February, 1926, a company was launched known as the NATIONAL FOOD PRODUCTS CORPORATION. Operating under Maryland charter, this corporation is empowered to hold securities of food companies (in ten of which it owns equities), and to purchase, sell and underwrite securities of concerns in which it may be interested.

<sup>3</sup> Other illustrations will occur to the reader, as, for instance, the Traction and Power Securities Company, Ltd., which was formerly controlled by the late George Westinghouse, but has recently been taken over by British interests.

**The Impulse of the War—The American International Corporation.**—The credit exigencies of the late war, and the apparently profitable opportunities for securing commercial and industrial participations abroad, encouraged the organization of a number of financing companies and financing investment trusts whose attention was devoted largely to foreign markets. While drawing from European experience in organizing such companies, American financiers have been quite as much originators as adaptors, as will be seen in the following brief description of several undertakings dating from war and post-armistice times.

Organized under New York State charter in 1915 by the National City Bank interests, and enjoying on its board of directors perhaps the most distinguished group of industrialists and financiers ever assembled about one table, the American International Corporation affords one of the most epic and yet sobering chapters of American war finance. Referred to at the time as "the world's largest discretionary financial pool," its charter conferred such broad powers of dealing in foreign and domestic securities, exploiting natural resources and developing foreign trade that the *New York Herald*, in its issue of November 24, 1915, jocularly stated, "Apparently there is only one thing in the heavens above, the earth beneath, or the waters under the earth in which the corporation cannot take a hand." The reference was to banking, from which, with insurance and railroading, it was excluded in domestic activities.

This enterprise, whose prospectuses rang with a note of war-time enthusiasm and patriotism, was to be the mightiest of Uncle Sam's non-official representatives in other countries, and to take full advantage of the special opportunities created by the European conflict. In order to attract and hold the talents of the nation's brainiest men, there was introduced a principle of managerial profit-sharing familiar in Germany, but as yet little tried in the United States. Of the entire capital of \$50,000,000, \$1,000,000 was in 7% preferred stock known as

"managers' shares," and entitled in addition to a one-fifth part of all the net profits available for distribution, after the \$49,000,000 in common stock had received a dividend at the same rate. These "managers' shares" were sold to officers devoting their efforts to the success of the undertaking, under an agreement of repurchase at current market price if and when the owner surrendered his connection. It was expected that debentures would be issued against foreign securities purchased, and that in this and other ways the corporation might be able to swing a business involving several hundred millions of dollars. One-half of the stock was subscribed by stockholders in the National City Bank, and most of the rest absorbed by other interests affiliated with the corporation—subscription rights occasionally selling for as much as \$35 for each \$100 share.

The investments of the American International were governed, in the words of its President, "by the relation of the company whose stocks or bonds are purchased to the general plan of the corporation's activities." Although the portfolio was not made public, the wide ramifications of the corporation's affairs were revealed in its holdings of securities issued by the following companies, among others: International Mercantile Marine (preferred and common), Pacific Mail Steamship Company, United Fruit Company, Simms Petroleum, United States Rubber (common), New York Shipbuilding Company, International Products (preferred and common), China Corporation, Siems Carey Railway and Canal (preferred and common), the Grace American International Corporation, the Italy America Corporation, the Amsinck Company, and the Allied Machinery Company. The purpose of the corporation being to participate in developing both American and oversea enterprise and to increase points of working contact among bankers, enterprisers and engineers, in the United States and abroad, it is not surprising that it developed the plan of engaging actively, through affiliated contracting and trading companies, in foreign engineering, shipping, construction, and commercial enterprise,



and that it financed such undertakings directly, or through resale of bonds to the public. Subsequent developments demonstrated the corporation's good fortune in not having utilized its debenture borrowing powers.

It requires a stretch of the imagination to consider the American International as in any sense an investment trust, although, as we have seen, its security holdings have at one time or another represented investment (almost entirely through shares) in fifteen or twenty different enterprises and in many of these, particularly those engaged in foreign business, it exercised no control over, and assumed no responsibility for the management. Indeed, the investments of the American International in foreign, or in domestic corporations doing a foreign business, were not to be made with a view of immediate resale, nor were they to be bought or sold for speculative profit.

The heavy fall in the securities markets in 1920 and the subsequent year, and the uncertainties of the world commercial markets resulted in "freezing" a large proportion of the corporation's assets and those of its subsidiaries. Although dividends of 10% or over had been paid in several earlier years, the corporation was so badly shaken by the economic cataclysm that dividends were passed. On October 6, 1923, it was reported that "holdings of listed securities which, against their current market value of \$5,000,000 cost the corporation more than \$21,000,000, must remain as 'frozen' assets." The gradual subsequent liquidation of the latter, while strengthening the cash position of the corporation, has revealed losses which perhaps could not have been entirely prevented, but which recall the enviable position at such times of the investment trust, with its greater diversification, its independence of subsidiary enterprises, and its comparatively steady financial intake and outflow. Late in 1924 a recapitalization plan for the American International Corporation was accepted by its stockholders, who agreed in principle to the purchase at \$70 a share of \$900,000 outstanding preferred ("managers") stock, and to conversion



of their own holdings into no par shares, whose asset value at the time was about \$40.

**Attempt to Form the Foreign Trade Financing Corporation.**—In Chapter II an analysis was made of the Edge Act, under whose provisions debenture-issuing corporations may be organized with Federal charters. As there stated, the two corporations which have operated under the Edge Act have primarily engaged in the acceptance and foreign exchange business and neither has been in any sense an investment trust. In this connection it should not be forgotten, however, that at least one noteworthy attempt was made to organize an Edge Act financing investment trust when, in late 1920, a large number of bankers laid plans for the launching of a \$100,000,000 company to be known as the Foreign Trade Financing Corporation.

The primary purpose of the proposed undertaking appears in its name, and the date of the attempt spells volumes to the student of American export trade. Those were times when halcyon dreams of continued exports on a vast scale had not as yet been shattered by the realization that foreign purchasing must at bottom have something more to sustain it than the multiplication of one American loan upon another. The puncturing of inflated prices was bringing its consequences of "frozen credits," uncollected accounts, and cancelled orders. To many people it appeared that a company of this sort, backed by adequate capital, could ferret out the good and the bad in potential orders from overseas, find sound revenue-producing bases for commercial credits, and capitalize the former by issuing its own notes and debentures against bonded and other claims granted by, or on behalf of, oversea importers. Thus could the export of American products—particularly capital goods—be facilitated, while banks and other financial institutions not especially equipped for this service might conceivably be relieved of a part of their excess of illiquid export paper

on mutually advantageous terms, and under new financing arrangements made with the foreign debtors.

This idea was basically sound, but the times were unpropitious by reason of these very circumstances which gave poignancy to the appeal for a financing company of this kind. The currents of international trade were too shaken and unsettled; it was difficult to give precise enough definition to the type of service by which the corporation proposed to make fruitful use of so large a capital; the project seemed to overreach itself and to fail of popular, and even whole-hearted professional, approval. The gray lights of 1921 further dampened the ardor of the promoters, and early in the following year the matter was finally dropped.

**Other Financing Companies of Recent Origin.**—The most superficial chronicle of the development of financing investment trusts in the United States must mention certain other companies, such as the American Foreign Securities Company, the Foreign Finance Corporation, and the Foreign Bond and Share Corporation.

Incorporated in Delaware in 1916, the American Foreign Securities Company provided the means by which a group of American bankers effected a loan of \$100,000,000 to the French Government, which was payable in 1919. The transaction was secured by deposit of collateral of estimated current selling value twenty per cent in excess of the principal of the loan. This collateral, which included bonds of European and South American countries, and of business corporations of the United States and Canada, was pledged with a trustee as security for 5% collateral trust notes of the American Foreign Securities Company. At the time repayment of the loan was due from the French Government the notes were retired in full; and the dividends on the company's operating margin of \$10,000,000 in capital stock averaged more than 8% annually.

The Foreign Finance Corporation was organized by the

Morgan interests under the business corporation law of New York, and with an authorized capital of \$10,000,000. Its investments are not disclosed to the public, reports are not published, and public subscriptions are not invited to its capital. Its investments are probably mainly in foreign enterprises and securities. The Foreign Bond and Share Corporation dates from 1919, when it was organized by a group of prominent American investment and commercial banking institutions to finance public and private enterprises in Latin-America, the Far East and Europe. The functions of the corporation were defined in its literature in the following terms:

. . . . to investigate investment proposals of every kind and in every part of the world; to finance such enterprises, public or private, as it considers sound; and to sell to American investors either the foreign securities so purchased, or else the debentures of the corporation itself; and by this means, while obtaining for American investors the benefit of high interest yields on foreign securities, together with security of principal, to foster and maintain the development of American export trade.

Associated with the undertaking as subscribers, directly or indirectly, to the capital stock were the Asia Banking Corporation, Mercantile Bank of the Americas, the American Foreign Banking Corporation, Banco Mercantile Americano de Cuba, the China & Japan Trading Company and other financial institutions. Its interests were rather those of a financing and trading company than an investment trust, and the financial and economic conditions following 1920 led to the withdrawal of several of the supporting financial groups. Since that time it has functioned principally as a means for liquidating or realizing upon certain "frozen" assets of other earlier collaborating groups. It is not active at the present time.

**The Overseas Securities Corporation.**—This company, which was organized in February, 1920, and whose affairs were terminated in 1923, had a capitalization of \$2,000,000, com-

prised of 2,000 shares of common stock of \$1,000 par value and 5,100 shares of "founders stock" with no par value. For their services in conducting the affairs of the company the directors were to receive 5% of the net profits but only when and as dividends were paid to shareholders. Remaining net earnings were to be divided in the ratio of 20% to the managers' shares and 80% to the common shares. The corporation made appeal for subscriptions from the public, although the high par value of its shares excluded participation by investors of smaller means. The Overseas Securities Corporation has on occasion been referred to as the "first American investment trust." Although the original company is no longer in existence, its advent marked an important step forward in the progress of the investment trust idea in the United States; and this despite the fact that in several ways it also departed radically from the limited scope of investment trust activities in the truer sense.

The greater part of the capital of the Overseas Securities Corporation was invested in foreign securities, and at times its different holdings have climbed up toward the hundred mark and represented a spread among twelve to fifteen countries. Although the charter permitted it to engage in financing foreign undertakings, its interests have undoubtedly been to a greater extent those of an investing company, and to a less extent those of a holding company, than the reports of the American International Corporation would indicate for that undertaking. It is significant of the spreading of their functions by financing companies that the Overseas Securities also engaged in brokerage and foreign exchange operations. That its activities were on the whole wisely conducted would appear from the terms of the dissolution, under which shareholders received the full par value of their stock and in addition a dividend, both in cash and in pro rata shares in a new "investment trust" which took over the less readily liquidated holdings of the earlier company.



**Recrudescence of Interest in Financing Investment Trusts.**—During the difficult years of world financial readjustment and business uncertainty which came after the hallucinations of 1919 and 1920, and before the adoption of the Dawes Plan and the introduction of other stabilizing factors into the European economic fabric, interest lagged in the creation of agencies of this sort in America.

In 1924, 1925 and 1926, however, there seems to have been a recrudescence of public attention devoted to overseas financing by promotive investment trust methods. Indicative of this is the creation, in 1924, of the *United States and Foreign Securities Corporation*, and the *American and Continental Corporation*. The financial groups primarily interested are Messrs. Kuhn, Loeb and Company, Dillon, Read and Company and the International Acceptance Bank. The latter has been organized primarily to carry on an international commercial banking business, its first field of operation being Germany, where it enjoys the association of strong domestic banks. Its entire initial stock issue of \$10,800,000 has been subscribed by American banks and affiliated companies, with the exception of approximately one-quarter thereof, which has been acquired by the United States and Foreign Securities Corporation.

This latter company was chartered by the same interests for the purpose of pursuing more strictly an investment business, although the following description of its activities appearing in a recent prospectus shows how far it is from being an investment trust:

The United States and Foreign Securities Corporation has been formed to buy, sell, underwrite, offer and generally to deal in, corporation, governmental and other securities, both American and foreign, and, when desirable, to take part in the organization and operation of corporations. The company will afford to its stockholders the means to participate in diversified investment and financial opportunities arising from time to time which would not be available to them as individuals. The company may extend its operations by issuing its own debentures.



Notwithstanding the fact that the company is investing approximately \$2,500,000 in the securities of the following companies: Brooklyn Edison Company, Continental and Commercial National Bank, Chicago, General Electric Company, Central Union Trust Company of New York, First National Bank, New York, in addition to subscribing heavily for the initial issue of capital stock of the American and Continental,<sup>4</sup> it is not yet possible to say whether it will somewhat resemble the investment trust in the diversification of its interests, or confine its activities to a few major lines of promotive, financing, issuing or brokerage activities. The initial heavy investment in capital stock of the American and Continental Corporation would seem to suggest the latter, although we read in the explanatory paragraphs accompanying the balance sheet of December 31, 1924, that:

The investments of the Corporation comprise a wide range of securities nearly all of a readily marketable character, classified substantially as follows:

Bonds.....	\$ 4,400,494.75
Stocks:	
Railroad.....	7,745,625.00
Bank.....	5,727,868.50
Industrial.....	2,530,107.50
Total.....	\$20,404,095.75

The capital set-up of the *United States and Foreign Securities Corporation* is as follows:

#### AUTHORIZED AND ISSUED CAPITAL (SHARES WITHOUT PAR VALUE)

	Shares
Held by the public	<div> <div> First Preferred Stock (\$6 cumulative dividend) (redeemable on any dividend date upon two months' notice at \$105 per share and accrued dividend)..... </div> <div>250,000</div> </div> <div> <div>Common Stock (one share distributed with each share of first preferred).....</div> <div>250,000</div> </div>
Held by organizers and associates	<div> <div>Second Preferred Stock (\$6 cumulative dividend) (purchased for cash by organizers at \$100 per share).....</div> <div>50,000</div> </div> <div> <div>Balance of common issued to latter in connection with second preferred.....</div> <div>750,000</div> </div>

<sup>4</sup> It is of interest to note the recent organization in Great Britain of similar financing companies interested in Central Europe. The reader is referred to the prospectus of the Mid-European Corporation in Appendix L.

The organizers, by thus furnishing brains and one-sixth of the capital, have reserved three-fourths of the net profits.

Brief mention might also be made of three financing companies which have recently been organized primarily to invest in certain European countries. *The Swedish American Investment Corporation*, a Delaware company, offered \$15,000,000 in 6½% participating preferred stock in December, 1925. Participation consists in an equal sharing with common stock, share for share, in dividends exceeding \$6.50 per share paid on common stock in any year. Voting power rests in the common stock, which has been issued in exchange for securities representing more than two-thirds of the entire assets.

The Corporation has been formed, it is announced in the prospectus:

. . . . by prominent Swedish interests together with American interests and owns, or will own upon application of proceeds of present financing, stocks and other securities including holdings in banks, real estate companies and industrial companies in Sweden and other countries. Under its charter it may, among other things, acquire, hold and sell securities either of present companies or of other companies or of governments or municipalities, and may issue its own securities to acquire such investments.

Among stocks held are nearly a half interest in the Grangesberg Company (iron ore), substantial equities in the Swedish Match Company, shares in Swedish and German city real estate companies, and stocks in various European banks.

*European Shares, Incorporated*, a New York State corporation, made its first public offering (100,000 shares of no par value) in January, 1926. The primary purpose of the company is to buy, sell and underwrite securities, probably largely in German banking and industrial enterprises needing increased operating capital. Close working contacts have been established with several large German financial institutions. Twenty per cent of the initially issued stock has been reserved for associated German interests. Management compensation takes the form

of profit sharing to the extent of 25% of the balance of net profits after setting aside cumulative earnings equivalent to \$4.00 per share per annum on the fully paid stock. Furthermore, affiliated banking groups have taken certain stock purchase options on authorized, but as yet unissued, stock amounting in all to 25% of that now in the hands of the public.

*The German Credit and Investment Corporation*, a Maryland company, also enjoys close relationships with German financial groups, and especially the German Securities Trustee Company which acts as a hypothecating and trustee agency on behalf of foreign interests extending credits to German industry. The initial offering of this corporation was made in January, 1926, in the form of 100,000 shares of first preferred stock enjoying cumulative dividends of \$7 per share annually, and each carrying one share of common stock. A smaller issue of second preferred stock has been purchased for cash by certain affiliated groups (including the United States and Foreign Securities Corporation, Dillon, Read and Company, and the German Disconto-Gesellschaft), while the latter have acquired all of the remaining common stock, amounting to 80% of the whole. The capital of the corporation will be used "to participate in investments and loans in Germany, Central Europe and elsewhere." Attractive opportunities for investment of American funds abroad result, again to quote the prospectus, from the "present widespread demand for capital on the part of foreign industrial companies whose individual requirements are limited to comparatively moderate sums and which therefore cannot go into the public money market."

#### **Investment Liaisons with Foreign Banking Groups.—**

Of especial interest in the United States is the recent organization of two financing investment trusts whose investments, confined for the most part to Europe, are made by the direct intervention of Belgian financial groups. These are known as the American-European Utilities Corporation, and the

American Belgian Financial Corporation (*Compagnie Financière Americano-Belge*). Each company has raised its initial capital privately, and both have European executive committees with considerable discretion to accept participations without the delays attendant upon detailed communication by cable or letter, and the necessity of obtaining prior approval of every transaction by the American board.

The American-European Utilities Corporation places its investments primarily through the *Société Financière de Transports et d'Entreprises Industrielles*, described in detail in Chapter XII. The American Belgian Financial Corporation enjoys the guidance of the *Mutuelle Mobilière et Immobilière* in the employment of its capital, and seeks to forestall possible losses through exchange depreciation in unstabilized currencies, by confining its acquisitions to common stocks, which, it is assumed, would, on the average, rise in market values roughly in proportion to currency inflation. It is the practice with many privately owned European public utilities to determine charges upon a gold basis, or to vary rates in general accord with the fluctuating prices, in the local currency, for such fundamental commodities as coal. The *Mutuelle*, which is fast becoming a third great power in Belgian finance, is commonly known as the bank of the Solvay interests, but its capital of Francs 50,000,000, and its reserves and other assets of more than half as much again, have enabled it to acquire substantial interests in twenty-four or more public utility, manufacturing, commercial, chemical, metallurgical, coal, railway and banking companies of different European countries and the Belgian Congo. In a memorandum prepared for the author in the late summer of 1925 by a director of the *Mutuelle*, a free translation of which follows, will be found not only the salient facts regarding the American Belgian Financial Corporation but also a point of view which furnishes interesting food for thought to Americans pondering the best means of productively employing our capital abroad:



The plan for creating a company of this type has resulted from the manifest lack of liquid funds in Europe as compared with the financial strength of the United States. The Americans have readily enough understood the advantage of making investments in Europe, but the essential condition for success in such undertakings is that they should associate themselves with European groups of established reputation, having back of them an earning power which would serve as an assurance of their success. To operate in any other way will only bring disillusion and disappointment.

One of the greatest difficulties in encouraging the importation of American capital into Europe has been the problem of exchange, but experience has demonstrated that in general quotations on the bourses for common stocks rise sufficiently to compensate depreciation in the local currency. In order thus to avoid the dangers of exchange fluctuation, American investors should become interested only in enterprises affording a basis of real values. In order to invest funds with a good prospect of profitable return, it is, therefore, necessary, as has been mentioned above, to depend upon the active cooperation of some established foreign group. Such a liaison between foreign groups and American investors permits a double supervision of the employment of American capital in different continental enterprises.

The Belgian institution which founded the American Belgian Financial Corporation is the *Mutuelle Mobilière et Immobilière*. This bank which, at the present time, has a capital of fifty million francs, of which twenty millions are paid in, possesses reserves amounting to thirty-six million francs. Two-fifths of the shares of the *Mutuelle* are held by the *Société Solvay & Co.*, of Brussels, and the remainder by members of this group. This bank is primarily industrial and groups about itself various enterprises operating in Belgium as well as in other countries. Moreover, the *Mutuelle* has very close banking connections with other important financial groups, especially in other countries. These relationships give to the bank many opportunities of participating in going enterprises, or assisting in the financing of new undertakings enjoying the most hopeful prospects. Such extension of its activities is based not only upon the technical survey which the bank makes through its own staff, but also upon the many sources of financial information which it has available concerning business affairs. The *Mutuelle* is also interested in the development of the Belgian Congo and the natural resources of this colony are so well known that it is needless to dwell upon the interesting opportunities offered for foreign capital by this vast expanse of territory.



The year 1924 saw the beginning of a general economic crisis in Europe and the year 1925 witnesses its continuance. From this there has resulted a general comparative depreciation on the bourses, further aggravated by the public appeal made by numerous industries for new capital. It is at this time that the American Belgian Financial Corporation was created, and, indeed, the moment could not have been better chosen, as it permitted profitable acquisitions at favorable prices, as well as the obtaining of subscription rights at minimum prices.

The American Belgian Financial Corporation has a capital of fifty million francs which has been subscribed as follows:

Messrs. Lee Higginson & Co. and their group . . . . .	34.135	shares of 500 francs
Messrs. White Weld & Co. . . . .	34.975	" " " "
Clark Dodge & Co. . . . .	5.890	" " " "
Mutuelle Mobilière et Immobilière . . . . .	14.850	" " " "
Messrs. Philippon & Co. . . . .	9.950	" " " "
Four individuals . . . . .	200	" " " "
	<hr/> 100.000	" " " "

The corporation has a European administrative council comprising seven individuals who are actively identified with financial affairs in Brussels and London. . . . M. Emmanuel Janssen, the President of the Mutuelle, has also become head of the new company.

Although the capital of the new company has not been called in proportion with the offering of attractive investments to the corporation, it is significant that by the first of July, 1925, seventy-five per cent of the capital will have been paid in. The present activity of the new company shows that it has been organized at a propitious moment, because it has succeeded in investing, under very favorable conditions, a sum of approximately thirty-seven million five hundred thousand francs. The investments which have thus been effected already show an interesting appreciation in value, and it is probable that the shareholders will very soon be able to receive a return on their investment.

The opportunities for profitable investment extended to the Mutuelle, and also through it to the new corporation, are continually increasing and it is probable that not long will elapse before it can be easily proved to American subscribers that they have been justified in placing confidence in the Mutuelle and that they will be wise to increase their participation in the rapid extension of the affairs of the American Belgian Financial Corporation. At the present time the stock of the American Belgian Financial Corporation is held by only a small group of shareholders, but it would seem advisable that ultimately the public, consisting for the most part of small subscribers, should be allowed to participate directly in the development of such enterprises.

We believe, in fact, that it would be advisable, with the later development of this corporation, that a public market should be created for its shares in order that the smaller capitalist might be permitted to obtain them.

It seems certain that, given the growing complexity of our present life, it is increasingly difficult for anyone to supervise all of his investment interests in view of the burden of his professional obligations. If he wishes to make the best use of his time he cannot afford to fritter away his energies in a detailed study of financial problems; and as a general rule the small investor does not have the proper information permitting him to form sound judgments. Is it not much simpler, therefore, that such a person should purchase shares in an investment trust? By this means, instead of investing his money in only one affair, he distributes it over a great number of risks.

We believe that the formula of an investment trust erected on such a basis as the American Belgian Financial Corporation is the most hopeful means for international investment which the future holds in store.

## CHAPTER XIV

### STOCK CONVERSION COMPANIES

**The Stock Conversion Trust Defined.**—In discussing the “financing investment trust,” we saw that it possesses three of the characteristics commonly attributed to the investment trust, namely, the raising of capital for the purpose of reinvestment in a variety of securities under the constant supervision of a skilled staff, but that it differs in acquiring controlling interests or participating in management of subsidiary enterprises. In this chapter we shall study an application of certain investment trust principles in forms peculiar to the United States. These undertakings, which are frequently referred to as “bankers share” or “trustee certificate” companies, are sometimes also known as investment trusts and are, with considerable inaccuracy, likened to the British investment trusts. Like many of the companies described in the preceding chapter, they also possess three characteristics of the investment trust, obtaining funds from subscribers for purchasing securities, avoiding responsibilities of direction or control by buying for investment only, and consistently maintaining a certain diversification, though slight as compared with the average trust. On the other hand, they lack the fourth characteristic of the investment trust, the cardinal principle of portfolio management. Although differing fundamentally from investment trusts as these have hitherto developed, these “bankers share” companies, which may more accurately be designated as “stock conversion trusts,” deserve treatment in any resumé of American developments, if only for the reason that they attracted so much popular attention in 1924.

The stock conversion trust, as lately developed, consists of

an issue of common stock carrying pro rata participating ownership in securities deposited with a bank or trust company, acting as "trustee." The securities so deposited are as a rule common shares of a selected group of enterprises usually confined to one industry; and in most cases neither the organizers nor the trustee may alter the composition of the underlying stock when once the participating shares have been issued to the public. The stock conversion company is, therefore, in no sense an active organization, and its very existence rests upon the express trust agreement through which its shares are issued to investors.

**Other Applications of the Same Idea.**—Variations of this idea are not new, and have been applied on more than one occasion to permit the purchase of high-priced stocks by investors of limited means, through a splitting up of proprietary interest in deposited securities, and the sale to investors of participating certificates issued in convenient smaller denominations.

A recent American application of this principle was found in the "Investors Share and Unit Corporation" of New York. This was an issue of "bankers shares" representing capital stock of the Ford Motor Company of Canada, Ltd. It was stated in the prospectus that the Corporation "buys Capital Stock of Ford Motor of Canada, Ltd., and under a protective Trust Agreement with the American Trust Company, New York, Trustee, deposits same with the Trustee, which in turn issues negotiable certificates for Bankers Shares representing one-hundredth part of one share of Capital Stock of Ford Motor Company of Canada, Ltd. . . . Certificates for Bankers Shares virtually are Ford of Canada Shares in all their attributes. Their owners are entitled to all dividends . . . (and) have the privilege of converting an aggregate of one hundred Bankers Shares into one share of Ford of Canada Capital Stock, at the office of the Trustee."

This issue has justly encountered strong disfavor, not only because of the illegitimate use of the name of Ford Motor Company, Canada, in sales propaganda, but because of the altogether unwarranted spread between the market value of the deposited shares, and the sale price of the participating units. In 1925 the quotation for Ford Motor of Canada shares on the Curb Exchange has been as high as \$524, and as low as \$491, whereas the sale price of the bankers shares issued against each Ford unit was \$650 in the case of some houses and \$750 in the case of others.

The principle is also differently applied in financial reorganizations, and in this guise has become familiar to many security owners. The deposit of securities, against which participating certificates of one sort or another are issued, has also been resorted to for the purpose of enhancing market value of the deposited shares by the creation, through these means, of new negotiable claims bearing other denominations and ranking differently in seniority.

ILLUSTRATION DRAWN FROM A BRITISH COMPANY.—Illustrative of the latter is the Stock Conversion and Investment Trust of London. This company was not organized as an ordinary investment trust. It had as its primary object the acquisition of such "heavy" railway common stock as the Union Pacific, the Canadian Pacific, and the Great Western; and the issuance of preferred and common stock against these holdings of railway common, for which it acted as trustee on behalf of the new shareholders. Against, for instance, \$1,000 in railway stock yielding 7%, three types of share might be issued by the trust—\$1,000 in 4% "first preferred," \$500 in 5% "second preferred," and \$1,000 in common. A quick calculation will show that the common might be expected to yield  $\frac{1}{2}\%$ , minus the deduction for expenses of the conversion process; and the idea animating such an operation is that the combined market price of the two types of preferred stock and



the one type of common would exceed that of the unsplit, original and deposited share.

Also of interest in observing British applications of this idea is the so-called "London, Midland and Scottish Trust," which has taken the name of the great railway whose stock it has been formed to convert, and some of whose sponsors are intimately associated with the Stock Conversion and Investment Trust. The new "trust," which is a development of 1924, has thus been explained and commented upon in the *London Stock Exchange Gazette* of August 28, 1924:

The London, Midland and Scottish Stock Conversion Scheme: There is a good deal of hardihood in the incorporation of the full name of the London Midland and Scottish Railway in the title of the Trust which is asking ordinary shareholders in the railway to hand over a portion of their stock, each £100 to be replaced by £97 10s of 4 per cent preference, £50 of 5 per cent preferred and £100 of deferred stocks to be issued by the Trust.

The supposed attraction of the offer is that the values of the three "splits" would in the aggregate exceed the market value of undivided L. M. and S. stock. This presumption has been put to the test of experience, for the Stock Conversion and Investment Trust many years ago bought considerable blocks of London and Northwestern and Northeastern stocks, splitting the former into three and the latter into two categories and offering these for sale. In practice the aggregate values of the splits generally exceeded those of the corresponding undivided stocks of the railways, with this invariable exception, that whenever there was a serious financial or political crisis afoot the position was reversed, and split stocks of the Stock Conversion Trust became worth appreciably less than the original railway stocks. Thus the predicted gain from holding split stocks in preference to undivided disappears just at the time when the necessity of realizing may become urgent.

For what may turn out to be a delusive, because unstable, gain in capital value, holders of L. M. and S. stock would sacrifice part of their current income; for on the basis of last year's 7 per cent dividend of the railway the £97 10s of Trust preference would return £3 18s, the £50 of preferred, £2 10s and the £100 of deferred, 7s 6d (for the Trust retains 2s 6d per cent of the nominal amount of the railway stock to cover expenses)—a total of £6 15s 6d against the full £7

enjoyed by the holders of £100 of L. M. and S. ordinary. The Trust deferred stock would rank as a speculative counter pure and simple, without attraction to investors accustomed to the solidity of sound dividend-paying railway securities, but if they sold the deferred they would deprive themselves of the prospect of obtaining the promised increment in capital value. The balance of advantage is heavily against the conversion proposal, which belongs to an era of finicking finance long obsolete and not worth reviving.

It is difficult for a serious student to deny the validity of these unfavorable conclusions, despite the asseverations of the chairman of the Stock Conversion and Investment Trust that the common shareholders of the L. M. and S. Railway ought to "transfer a large portion of the ordinary dividend into the higher region of security which is governed by the value of Government and all first-class securities." The view of the *Stock Exchange Gazette*, quoted above, is apparently shared by the London Midland and Scottish Railway itself, which has issued a circular recommending that its shareholders reject this offer of conversion.<sup>1</sup>

**Drawbacks of Such Conversion Operations.**—Such considerations as the expenses of conversion, the confidence of the public, or otherwise, in the promoters of the scheme, and ever varying financial and economic conditions, are likely to create considerable discrepancies between market actualities and a theoretical demonstration of advantages to be gained in capitalizing a fairly dependable larger annuity through splitting it into a very dependable smaller annuity and an uncertain residue. It must not be forgotten that such operations, instead of increasing revenue, actually diminish it by costs of conversion and trust administration. Moreover, the common share, or deferred claim, which is the most readily influenced by increasing revenue accruing to trustees of the original stock, is also most precipitately affected by declines in that

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<sup>1</sup> The unfortunate and misleading practice of incorporating into the name of the conversion trust the full name of one or another of the corporations whose stock it is proposed to convert in part, has also appeared lately in the United States. This practice has now been largely abandoned in America.

revenue; and after a lowering of dividend or the passage of other unfavorable factors, is nursed back into public confidence with only the greatest difficulty. Thus the net increase in realization values, which is the sole purpose of conversion, is likely to be an illusive, if occasionally real, advantage.

**Stock Conversion Trusts in the United States.**—The stock conversion, or “bankers share” company in the United States is, consciously or unconsciously, an adaptation of certain foregoing ideas. There is this great difference, however, that the stock conversion company in its latest manifestations aims not primarily at enhancing market values by “splitting” common shares into new stock of preferred and deferred type, but at affording security by “converting,” for example, a certain “unit” composed of purchased common stocks in several different corporations into a far greater number of share claims, each equally participating in dividends accruing to all of the deposited securities. The stock conversion company, therefore, as lately developed in the United States, is a limited application of the investment trust principle of diversification of risk by means of devices hitherto employed mainly for other purposes. Because its scope is different, the stock conversion company does not as a rule issue several types of participating shares, diversification within the limits of the trustee deposited securities being sufficiently effected by one type of certificate representing pro rata claims upon the former.

**AN ILLUSTRATION.**—Among other stock conversion companies of recent origin may be mentioned the United American Electric Companies, Inc., whose prospectus is sufficiently quoted to give a succinct idea of the composition of the trust:

UNITED AMERICAN ELECTRIC COMPANIES

(Incorporated under the laws of the State of Delaware)

THE COMPANY

United American Electric Companies, Incorporated, which is entirely independent of the said ten Edison Companies, does not own or operate

electric plants or manufacture or sell electric current or equipment. It owns Shares of the Common Stock of nine and of the Preferred Stock of one of the said ten Edison Companies, as set forth below. Under a Trust Agreement dated April 9, 1924, it deposits these Shares with the Empire Trust Company, 120 Broadway, New York, as Trustee, in blocks of 190 shares each, totalling \$10,000 par value (calculating as of \$100 par value each the 25 shares that are set out as of no par value); and against each such block it receives 1,000 Bankers Shares of \$10 each par value, each of which, therefore, represents a 1-10 interest in each \$100 par value, and a 1-1000 interest in each block of the said \$10,000 par value of Shares deposited with the Trustee.

#### PURPOSE OF ISSUE

The Bankers Shares afford an opportunity for investment in the securities of these ten Edison Companies which as a whole have hitherto been available only to people of large means, banks and other financial institutions. They enable the comparatively small investor, to whom an investment in these securities has been impossible because of their high price, to participate in the annual profits and periodical stock dividends distributed by these ten large and prosperous Edison Companies, which, with their eighty-two subsidiaries and associated companies, form the strongest and most important group of light and power companies in the United States.

#### BANKERS SHARES

The Bankers Shares are issued in the form of Bearer Certificates, with Dividend Coupons attached in denominations of 5, 10, 25, and 100 Share Certificates. Under the provisions of the Trust Agreement the holders of Bankers Shares have the right, upon two months' notice in writing prior to any dividend date, to surrender their Bankers Shares in blocks of 1,000 shares and receive therefor one block of deposited stocks of 190 Shares of the said total par value of \$10,000.

#### EDISON STOCKS DEPOSITED

The Trust Agreement provides that Stocks of the ten Edison Companies shall be deposited with the Empire Trust Company, as Trustee, in blocks, all being Common Stocks except No. 8 below which is 7 per cent Cumulative Participating Preferred Stock, and that each block shall be identical (thus permitting of no substitution of other securities) and shall consist of 190 shares of \$10,000 par value (calculating as of \$100 par value the twenty-five shares that are set out as of no par value) and in the following proportions:



Name of Company	Par Value of Shares	Shares in Unit	Par Value in Unit
American Power and Light Company.....	\$100	5	\$ 500
Brooklyn Edison Company.....	100	10	1,000
Commonwealth Edison Company.....	100	9	900
Consolidated Gas Company of New York.....	(no par)	20	2,000
Detroit Edison Company.....	100	10	1,000
Edison Electric Illuminating Company (Boston).....	100	10	1,000
Edison Electric Illuminating Company (Brockton)....	100	1	100
Metropolitan Edison Company.....	(no par)	5	500
North American Company.....	10	100	1,000
Southern California Edison Company.....	100	20	2,000
		190	\$10,000

**Other Stock Conversion Companies.**—The group which is responsible for the United American Electric Companies has also organized “United American Chain Stores,” representing stock in fourteen chain store systems, and the “United American Railways,” representing stock in seventeen common carriers. Other undertakings of the sort are the “United Bankers Oil Company” (shares in ten Standard Oil Companies), and the “American Trustee Share Corporation,” which is a deposit of common shares in ten corporations of virtually as many different industries. This corporation, at the time of writing, in September, 1925, offered a further issue of “Diversified Trustee Shares,” each 1,000 of which represents ownership of 146 shares in 24 different corporations—6 railroads, 6 public utilities, 7 industrials, and 5 Standard Oils. The principles followed are the same. The charges deducted in advance would appear to be slightly less than 10% of the public’s purchase price. The “Nation-Wide Securities Company,” whose prospectus is reproduced in Appendix J, issues “trust certificates” secured by stocks of twenty-five leading industrial, public utility, and railroad companies of America, deposited with The Colorado National Bank of Denver, Colorado, Trustee.

**Common Features.**—In all of these stock conversion companies will be found the following similar features:

1. Purchased common shares are deposited with the



trustee in uniform "blocks" or "units," representing a specified amount of stocks, distributed among the shares of the different corporations in which investment is sought according to predetermined ratios. Occasionally the purchase of a small proportion of preferred stock is permitted.

2. In return for the deposit of these securities with the trustee, the stock conversion company receives "bankers shares," or "certificates," representing fractional interests (frequently in units of one-thousandth) in the "blocks" of deposited shares.

3. These "bankers shares" are for the most part sold to the public as bearer certificates with dividend coupons attached, and resemble common shares except that they carry no voting power. Their selling price includes dividends accrued at any time.

4. The "bankers shares" are issued in different denominations; and as they are without par value, the denomination is expressed in units of participating interest in the deposited "blocks."

5. Issues of "bankers shares" are only limited by the quantity of collateral offered by the stock conversion company to the trustee.

6. Any holder of "bankers shares" who has accumulated a sufficient number to represent full claim to a "block" of deposited securities enjoys the right of actual conversion into these securities by effecting the exchange at the office of the trustee.

7. No substitution, or change, can be effected in the shares deposited with the trustee, except that in a number of stock conversion companies a small percentage may be sold, and the proceeds reinvested in shares of the other companies already represented in each "block" or "unit." For instance, the prospectus of "bankers shares" issued by the United American Railways declares: "The Trust Agreement also provides that, under certain circumstances, the deposited stocks of not more than 3 of the said 17 companies or more than 20% of the total

par value of the deposited stocks may be sold and the proceeds reinvested in the Stocks of the remaining Railway Companies in the unit." Similar provisions are found in the case of the United American Chain Stores.

8. The management of the stock conversion company's affairs is, therefore, largely automatic, and consists almost exclusively of the distribution by the trustee to holders of "bankers shares" of dividends received on the deposited stock, as well as the cash return derived from sale of any stock dividends or subscription rights.

9. The profits of promotion for the brokers, and the costs of administration by the trustee, are fully collected in advance by deduction from the price paid by the public for "bankers shares"; and the entire yield of securities purchased with the net remaining amount and deposited with the trustee, is, therefore, distributed to the holders of the marketed "bankers shares." The brokerage and other charges deducted in advance have amounted to from 12 to 14%, and over, of the price paid by the public, in different "bankers shares" offers. In one case, for instance, the difference between cost of the deposited securities, and the price exacted from the public was \$2—the former being approximately \$12, and the latter approximately \$14. Of this \$2, thirty cents went to the originators of the scheme, sixty cents to the broker for his sale commission, and \$1.10 to the trust company serving as trustee, and to the brokerage house responsible for the issue.

10. Very generally, the indenture under which at least the earlier of these "bankers shares" are issued permits the organizers to make what profits they can upon the deposited securities. By this is meant that the cost of acquisition of such securities, prior to their deposit with the trustee, need have no relationship with the price paid for the "bankers shares." What profits have been made are, therefore, not to be determined by comparing the offering price of the certificates with current cost of the trusted stocks; the question is rather, if the market

has been a "bull" one, the original cost of the latter, perhaps in the earlier phases of the market.

11. The price, and realization value, of "bankers shares" therefore varies directly with the aggregate market price of the deposited securities, and the amount of dividends accrued thereon; but the "bankers shares" must always necessarily sell, at the time of their initial offering to the public, for a higher price than their original conversion value. The latter circumstance results from the fact that brokerage fees and remuneration for trustee services are deducted in advance. These are legitimate charges for the conversion operation, and no objection can be made to them provided the operation is in itself desirable, and provided also that the ratio of cost is small enough to leave adequate real values behind the "bankers shares."

**Certain Recent Developments of the "Bankers Share" Principle.**—It may be of interest to note here two more recent developments of the "bankers share" principle which involve a wider degree of diversification or less rigid restrictions concerning substitution. The "Mines and Metals Investment Trust" has lately issued "trustee shares" representing participation in common shares of forty-four mining and smelting companies. These stocks, to quote the prospectus:

. . . . after their purchase by the Mines and Metals Investment Trust, Inc., are transferred into the name of and deposited with the Trustee, the Montreal Trust Company, Montreal, Canada. The Trustee will collect all dividends as and when paid by each of the forty-four companies and deposit the same to the credit of the Trustee Shares in the Royal Bank of Canada, who will pay the dividend coupons due on the 31st day of January and 31st day of July each year. . . . .

Trustee Shares are certificates with Dividend warrants attached payable January 31 and July 31. Each block or unit is identical and consists of exactly 698 shares having a par value of \$10,050 as specifically set forth in the Trust Agreement. The Trust is permitted to issue 1,000 Trustee Shares against the deposit by it with the Trustee

of a complete unit. Each Trustee Share, therefore, represents a 1-1000 interest in each complete unit. . . .

Under the provision of the Trust Agreement, the Trustee Shares are issued in the form of bearer certificates, in denominations of 10, 25, 50 and 100 shares, with dividend warrants attached. Holders of Trustee Shares have the right, upon ten days notice in writing, providing the transfer books of the companies are open, to surrender their Trustee Shares in blocks of 1,000 shares and receive therefor one whole unit of the deposited stock represented thereby. Under the terms and conditions of the Trust Agreement, these securities exactly as deposited in blocks as hereinafter set forth, are held by the Trustee for the benefit of the holders of the Trustee Shares and there can be no substitution, except as provided.

The provisions for substitution are interesting, and represent a slight advance upon the more rigid requirements of the earlier mentioned companies:

If any stock deposited with the Trustee should give indication that its value or earning capacity may be impaired and is no longer desirable from an investment standpoint, the facts must be communicated to the Trustee who shall thereupon sell such stock and reinvest the proceeds in the remaining shares in the unit, or distribute the proceeds equally among the holders of the Trustee Shares.

If any stock in the unit should show a market appreciation of 25 per cent or more above the cost of original acquisition and it be deemed advisable to realize such profit, the Trustee may sell such stock and reinvest the whole or any part of the proceeds of such sale in any of the remaining shares of the unit or may distribute such proceeds or any part thereof ratably to the holders of Trustee Shares on the next dividend date, or such proceeds or profits may be set aside in a special reserve fund for the benefit of the holders of these Trustee Shares.

All stocks deposited with the Trustee as collateral security for the issuance of Trustee Shares must at all times continue to conform to these strict rules and can not be altered or changed, nor can any other substitution be made by either the Trust or the Trustee.

The Financial Investing Company of New York, which operates also as a general investment trust, has introduced lately some new variations of the "bankers share" idea in the

form of "Foreign Government Bond Trust Certificates." These differ from the foregoing primarily (1) in the depositing of foreign government bonds instead of domestic common shares, (2) in the appeal to the investor of a greater yield to be obtained on foreign government than domestic bonds owing to the comparative undervaluation of the former in the American markets, and (3) in the provisions for substitution (either to take gains or to prevent losses) which are much more liberal than those mentioned heretofore and are explained in the following quotation from the prospectus:

#### FOREIGN GOVERNMENT BOND TRUST CERTIFICATES

TRUSTEED BONDS: Bonds will be deposited with the Trustee in identical Investment Units, each of which will consist of one \$1,000 piece of each of fifteen foreign government bonds, *listed on the New York Stock Exchange*, as follows:

Austria Guaranteed 7% Bond, 1943	Hungary 7½s, 1944
Belgium External 6s, 1955	Peru External 8s, 1944
Czechoslovak External 8s, 1952	Bolivia External 8s, 1947
Finland Sinking Fund 7s, 1950	Chile 8s, 1946
France External Sinking Fund 8s, 1945	Salvador First Lien 8s, 1948
Germany External 7s, 1949	Uruguay 8s, 1946
Greece 7s, 1964	Brazil External 8s, 1941
	Japan External 6½s, 1954

PROTECTION OF PRINCIPAL: To avoid depreciation of principal or to take capital gains, the creator of the Trust, Financial Investing Co. of New York, Ltd., may require the Trustee to sell any of the bonds held by the Trustee and, upon the approval of owners of Trust Certificates given at a meeting to be held within fifteen days after each such sale, may require the Trustee to reinvest such proceeds in additional bonds to be held by the Trustee as a part of each Investment Unit.

Save for the further fact that these "Foreign Government Bond Trust Certificates" are registered, the income being payable by check rather than by the clipping and presentation of coupons, they do not essentially differ from the ordinary bankers share.



**Pros and Cons of the "Bankers Share."**—The "bankers share" holder enjoys absolute assurance that the securities underlying his participating shares will never be altered save within the narrow limits clearly specified in the trust deeds. The administration of the deposited "blocks" is imposed upon the trustee in such clear terms as to minimize the possibilities of abuse. If in the administration of the stock conversion company's affairs, however, the "failures of commission" are eliminated by the strict character of the trust deed under which the "bankers shares" are issued to the public, the "failures of omission" are not only not avoided, but are practically made unavoidable. Efficient management of a moneyed estate consists not only in refusing to buy questionable securities, but also in withdrawing from possession of shares in moribund or unsound enterprises, on the best terms obtainable, and reinvesting in stocks or bonds of higher quality. Such latter services cannot be rendered by the trustee under a "bankers share" agreement, as little or no discretion is left with the administrators.

It is for this reason of great importance that the prospective investor should check over with care the list of deposited securities. The collateral base of the "bankers share" being virtually unchangeable, its soundness is vitally dependent upon the continued prosperity of a small number of companies to whose fortunes it is irrevocably committed. If the original choice is not made with discretion and good judgment, the stock conversion company is as capable of abuse in one way as the investment trust is in other ways common to all corporate activity—the possible mismanagement of current affairs by its directors. The irrevocable trust deed drawn in favor of the "bankers share" holder does not make this type of participating certificate superior to the common share in a regular investment trust. As the latter may become practically worthless because of careless management (as is the case with any form of share), so it is also likely to prove in the long run far sounder and more profitable than the "bankers share," if the

standards under which the affairs of the investment trust are administered are rightly drawn and if advantage is taken of the many ways open to it of increasing the earning assets and the equity behind the deferred stock.

It is maintained by promoters of stock conversion companies that the added market created for deposited securities by bringing the force of the smaller investor to bear upon the demand for them will tend to raise the conversion value of "bankers shares." This is problematical. Certainly huge quantities of "bankers shares" would have to be sold, greatly to affect the market for any one of the deposited securities. In this case appreciable amounts of collateralised shares would have become lodged in hands of trustees—a condition which might conceivably restrict the volume of current dealing in them on the stock exchanges and make the current market for them less dependable.

In any case, the realization value of any security in the long run must accord with the public judgment of its return and safety, and it seems doubtful if any artificial factors of demand can permanently raise its price. Assumptions of this kind are purely hypothetical, and cannot be demonstrated, so far as the writer is aware, by reference to American or foreign experience.

The Governing Committee of the New York Stock Exchange adopted, in July 1924, the following resolution:

That participation by a member of the Exchange or Stock Exchange firm in the formation or management of investment trust corporations or similar organizations, which in the opinion of the Governing Committee involve features which do not properly protect the interests of investors therein may be held to be an act detrimental to the interest or welfare of the Exchange.

This resolution had reference primarily to stock conversion companies, and the possibilities of abuse in a careless application of the investment trust principles. It is probably true that the Governing Committee looked with disfavor upon

what several of them conceived as a method of immobilizing securities, and taking blocks of them off the active trading lists.

A similar note of warning with regard to further experimentation is sounded in the *New York Times* of September 7, 1924, by Winthrop Burr, Chairman of the Committee on Business Conduct :

It [investment trust] is not a "get-rich-quick" idea and should not be permitted to fall into the hands of men filled with that design. Our wish is to put the public on its guard and to help our own members at least to avoid forms of this plan which are not calculated to protect their customers.

**Fundamental Differences between the Stock Conversion and the Investment Trust.**—The stock conversion company in its latest form (investment trust) is a comparatively new experiment. Arrangements of the kind are not to be commended by reference to foreign experience, for the successful investment trusts of Great Britain are, without exception, run on radically different principles, and the European companies are generally built on altogether different lines. It is difficult to escape the conclusion that the majority of stock conversion or bankers share companies have been created quite as much to afford immediate profit to their promoters as to fill any long-felt need in American finance.

By way of recapitulation, the chapter might be concluded with a brief résumé of the principal differences between the stock conversion, or "bankers share" company, and the investment trust :

1. The investment trust accomplishes a far wider distribution of risk than the "bankers share" company.

Distinct investments of the former run often into the hundreds. The deposited securities of the latter comprise generally issues of but ten or twenty companies, while in only two or three instances do these companies represent different industries. Moreover, the securities bought by stock conversion

trusts are practically entirely common stocks, while the investment trust diversifies its holdings among bonds, preferred stocks, and common shares.

2. The skilled management of an investment trust guards its assets by taking advantage of profitable opportunities to buy and sell, and alters its investments gradually and advantageously as circumstances may determine.

The "bankers share" company, on the other hand, generally permits no change in the composition of its investments. Once the securities have been deposited and the participating shares issued, the administration of a "bankers share" or similar company is purely the routine work of collecting dividends, and distributing them pro rata to holders of the participating shares. Where slight alterations are permitted in the composition of the deposited securities, the net result of these changes is to reduce further the diversification of the latter.

3. The "bankers share" investor buys with assurance that the underlying collateral will remain unaltered. The common share holder of an investment trust, on the other hand, enjoys the usual voting power in its control, and entrusts his directors with the task of maintaining sound securities in the portfolio and altering their composition as market circumstances warrant and the interests of the trust require, within limits, and according to standards, specified in the by-laws.

The purchaser of an investment trust bond is occasionally secured (as described in the following chapter) by pledge with a trustee of mixed collateral having superior realization value, under an agreement permitting withdrawal in return for the substitution of equally acceptable bonds and shares.

4. The investment trust usually aims to build up substantial reserves by reinvesting any profits made in turnover, or in altering its investments. It also frequently shunts a portion of its annual net revenue to the reserves. The "bankers share" company, on the other hand, automatically distributes all of its earnings as dividends on the participating shares.

5. The shareholder in an investment trust generally enjoys certain other substantial sources of revenue, among which is the margin, accruing to net earnings, between the borrowing rate on its adequately secured bonds or debentures, and the yield which may be obtained by investing funds so borrowed. Short-term loans from banks may also be negotiated at times, and funds not immediately invested may be loaned on ample security. British investment trusts command other forms of income, including especially fees for participating in reputable underwriting syndicates.

The "bankers share" holder is by this token entitled to his share of income on the pledged securities. By way of contrast, the shareholder in an investment trust is part owner of a distinct type of business enterprise, whose income is derived from several sources, and whose operating capital is obtained in a number of ways.

6. For the above reasons, both the dividend and the market price of "bankers shares" fluctuate widely in accordance with general business or financial conditions, as these impinge upon the narrow list of securities held.

Shares in investment trusts, on the contrary, are more likely to show a steady tendency. Dividends paid on them, given good management, tend to be steady or advancing, not only because bonds and preferred stocks constitute an important part of the investment trust portfolio, and its income is thus more stable, but also because its earning reserves represent a solid "line of defense" enhancing the equity behind the securities it issues to the participating public.



## CHAPTER XV

### A PIONEER AMERICAN INVESTMENT TRUST

**Originality among Investment Trusts in the United States.**—Neglected though the investment trust has been in the United States, comparatively speaking, to the present time, there are not lacking undertakings which may properly be so classified. The progress of these recently organized trusts is being watched with keen interest in the financial world, for they are applying in a new environment at least some of the principles which nearly fifty years of experience have made well understood in the investment markets of London and Edinburgh. As their success or failure will considerably influence the course of American developments in this direction, and the modification or improvements which conditions in the United States may suggest in organization and administration, it seems advisable to examine them in some detail in this and the following chapter. This is particularly true in view of the fact that among the ten or a dozen American undertakings showing most or all of the characteristics of the investment trust (raising capital by shares and bonds, broad diversification, portfolio management, freedom from managerial or directive responsibilities), there are emerging at least three or four distinct types—a far greater variety in fact than may be found in any other country. For this reason a brief survey of the principal trusts now functioning in the United States is in order, even though, in the effort to present a clear-cut picture of each, a certain amount of repetition becomes necessary of material earlier introduced as illustrative of various phases of investment trust management and organization.

**International Securities Trust of America.**—The largest and one of the most active among the purely investment trusts

now existing in the United States is the International Securities Trust of America, whose organization in April, 1921, represents one of the first endeavors to introduce into our country this type of financial institution. Functioning as a common law trust of Massachusetts, it only began its more active public appeal in the late spring and early summer of 1923, when an amended declaration of trust was adopted which constitutes its present operating basis. This declaration, which sets forth the requirements governing the activities of the board of trustees, vests full voting power in the shareholders and corresponds to the ordinary corporate charter, is reproduced in full in Appendix C.

**Purely an Investment Undertaking.**—The business of the trust, it is declared in Article IV “shall be limited in nature to the investment and reinvestment of capital. The trustees shall not use the funds of this trust in connection with, nor engage the trust in, any enterprise involving promotion, business management or underwriting.” These stipulations distinguish the trust as an investing one, and make impossible the undertaking of any activities typical of the financing company. In one respect the Trust here breaks sharply with the practices of British investment trusts, many of which engage in a certain amount of underwriting in connection with those issues acceptable for permanent investment in case the underwriting guaranty must be drawn upon.

**Basic Security.**—In Article IV of the Amended Declaration of Trust will be found the fundamental principles by which the trustees must be guided in authorizing investments. These provisions may be summarized as follows:

1. Funds should be invested in marketable securities according to regulations adopted by the trustees, but conforming, in any case, with the following standards:

- (a) The issuer, whether governmental or private, shall have been established for at least four years.

- (b) Accurate data bearing upon history, management, assets, earnings and income of the "governmental authority corporation or organization" issuing the securities must be obtainable.
- (c) The nation in which the securities have originated must have demonstrated its financial stability, and its respect for the rights of private property.

2. The trust is forbidden to purchase, or acquire in any way, its common shares. The same inhibition applies to its preferred stock, its bonds and other evidences of indebtedness, except that these may be purchased for retirement and cancellation.

3. The trustees are authorized and instructed to sell any investments which have so deteriorated as not to be further eligible for purchase by the trust; and such sale or disposition must be effected within one year of the ascertainment of this fact.

PRACTICAL TESTS IN APPLICATION OF ABOVE PRINCIPLES.  
—Working in accordance with the standards sketched above the trustees of the trust have drawn up a set of practical tests which are applied to every contemplated purchase of securities for the portfolio. These tests have to do, in the case of common and preferred stocks, with such factors as:

- 1. The ratio which the net earnings of the security, in given periods preceding purchase, bear to the purchase price;
- 2. The rate of return on the purchase price represented by dividends earned and paid during certain periods prior to acquisition;
- 3. The net asset value as compared with the purchase price, (which must be at least 150% in the case of preferred or common shares, and 200% in the case of bonds);
- 4. The extent to which the security is tried, seasoned, and marketable.

In the purchase of bonds and other evidences of indebtedness, the above-guiding principles are followed in so far as

they are applicable to such securities, and save for government, state or municipal bonds, the book value of net assets must be considerably higher than in the case of common and preferred shares. These provisions have been elaborated independently, but after study of American legislation defining eligibility in trustee investments, of "Blue Sky" laws of our various commonwealths, determining the standards to which public offers must conform in the respective states, and of investment standards of British investment trusts. In order to preserve flexibility, as far as this is consistent with safety in managing the portfolio, criteria of the kind suggested above are made applicable in alternate groups, with the result that proposed investments not reaching all requirements, but showing exceptional strength under several heads, may be given the consideration their intrinsic strength merits.

The by-laws have also defined more clearly the conditions under which trustees are obligated to dispose of undesirable holdings. Such liquidation on the best terms obtainable must follow within reasonable time after disclosure, by data available to the trust, of a shrinkage in book value of underlying assets within certain agreed minimum protective margins above the original acquisition price.

#### **Provisions for Altering the Composition of Portfolio.—**

Section 5, Article IV of the Company's Amended Declaration of Trust, further states that "The Trustees, in their discretion, at any time and from time to time, may sell and dispose of any securities belonging to the Trust, and may invest and reinvest in accordance herewith the proceeds received therefrom." The next section also reads as follows: "The Trustees, from time to time, may withdraw any or all securities . . . for the purpose of selling or disposing thereof or for the purpose of depositing or pledging the same as security for the payment of obligations of the Trust."

The right of turnover is thus reserved in the declaration of

trust, and in this respect the International Securities Trust follows the standards of the British trusts. Managers of the trust are enabled to take advantage, within the standards of purchase specified by the declaration and by-laws, of upward and downward swings in the securities markets—now selling and now buying when these fluctuations in values touch the predetermined disposal or acquisition figures for different issues within the field of the trust's permitted investments.

**Standards of Diversification.**—The standards of diversification of the International Securities Trust, which had assets exceeding \$9,500,000 on March 1, 1926, may be here summarized under the headings (1) by country, (2) by type of security, and (3) by issuer.<sup>1</sup>

1. BY COUNTRY.—It is stipulated in the amended declaration of trust that at any one time not more than 70% of the total funds of the International Securities Trust may be placed in securities originating in the United States; that not more than 55% may be invested in securities of English origin; and that 35% shall be the maximum for any other country.

The present portfolio contains securities originating in twenty-eight countries, the proportion of American investments being somewhat higher than for any other country.

2. BY TYPE OF SECURITY.—The safeguards in purchasing described in preceding paragraphs have created obstacles comparatively speaking, in the acquisition of common shares, and for this reason bonds and preferred stocks predominate in the portfolio. Under the provisions governing more specifically the geographical distribution of investments, certain maximum percentages of the total amount available for investment in any one country may be utilized in purchasing government and municipal bonds, and common and preferred stocks. (See Article IV, Appendix C.) The distribution of the portfolio by type of security (September 1, 1925) follows:

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<sup>1</sup> The balance sheet of the trust is reproduced in Appendix D.



	Per Cent
Bonds.....	74
Preferred stocks, and bank shares.....	22
Common stocks.....	4

3. BY ISSUER.—It is provided that in any case the trust shall never purchase or hold a majority of any one issue of securities. In practice, however, not more than  $\frac{1}{4}$  of 1% of the assets of the trust are on the average invested in securities of any one issuer, so that at least four hundred different issuers are represented in the portfolio at any one time. On September 1, 1925, there were over 475 issuers represented among the 575 different securities held. In the maximum amounts which may be invested in any one country, certain maximum ratios are given for investment in securities of any one issuer, while other provisions assure an adequate distribution among different classes of business or industry. (Article IV, Appendix C.)

**Purchasing Securities in Depressed Periods.**—A guiding principle applied in purchasing for the portfolio of International Securities Trust is the acquisition of any security at a figure representing a potential profit, that is, for a price considered below the intrinsic worth as revealed by careful statistical analysis. Starting with the more than 200,000 issues, representing a majority of the world's securities, as its possible field of investment, the trust, by the application of simple statistical tests, has eliminated as ineligible some 85% of all securities considered. The remaining 15% is subjected to further analysis, classification and grading with a view of constantly casting up those which are inherently most desirable. At any given time orders are outstanding in a dozen or more international markets for, on occasion, as many as a thousand different securities, but only at purchase prices which as a rule are below the prevailing market. These bids are for definite quantities at given prices, the several offers for purchase being made at various hypothetical figures in such a way that the number of shares or bonds acquired, as the case may be, increases as the price drops.

**Capital Profits.**—Of these outstanding orders only comparatively few are filled at any one time, but the law of average operates to insure a considerable volume of daily purchases. Such a system of buying, involving continual analysis of many hundreds of securities, automatically directs attention to depressed markets in any part of the world, for it is in such centers that purchasing is necessarily most active at any time. The securities purchased being leaders in their class, they tend to be in the vanguard of any recovery movement and among the first to register book appreciation. When it appears that such appreciation, measured by current market quotations, has reached a point where the trust can not longer afford to hold certain securities, they are sold and the proceeds reinvested in issues of higher current yield. In other words, when the money which investments will yield upon liquidation may be employed to acquire other eligible securities which, with a view to all the circumstances, afford higher return, a re-alignment generally occurs in the trust's investments.

**The Problem of Guarding Portfolio.**—Guarding the interests of an investment trust in placing its capital constitutes a problem embodying, among others, the following elements.

I. THE DEGREE OF DIVERSIFICATION IN THE PORTFOLIO.—We have seen in earlier chapters that the British trusts do not bind their directors by detailed written instructions covering standards of investment, or specifying degree of diversification by arbitrary percentages of capital. In the United Kingdom the investment trust has attained such popular confidence that the names of certain directors and organizers, and the unquestioned soundness of the many trusts for which they have long been responsible, constitute a sufficient pledge for investors that their money will be wisely administered. It is to be hoped that such conditions will ultimately obtain in the United States. But as investment trusts are as yet for the most part an unknown

quantity in this country, it is only natural that public esteem should be cultivated by such clearly imposed safeguards that "he who runs may read."

2. THE BASIC SOUNDNESS OF SECURITIES PURCHASED.—The International Securities Trust avoids purchases savouring of speculation, or of a new or untried character. These provisions are aimed to assure a portfolio of strength and quality at a time in the evolution of American investment trusts when carelessness or mistakes of judgment might have unfortunate consequences for future undertakings of the sort. Here again it must be observed, however, that foreign practice has sanctioned less conservative methods on occasion, for many of the highly successful investment trusts of the United Kingdom have not hesitated to acquire common shares of new or quasi-speculative enterprises in quantities justified by their proportional holdings of prior-lien securities and the spreading of risk which underlies all of their investments.

3. REASONABLE COST OF SECURITIES PURCHASED, AS COMPARED WITH THEIR YIELD AND BOOK VALUES.—The advisability of an acquisition is, of course, determined not only by its quality, or prospective return, but also by the price which must be paid for it. The duty of investment trust managers is to obtain as high an average yield on the capital entrusted them as is consistent with its safety. There are times when a security basically sound would not constitute wise investment for a trust because its current selling price represents an unnecessarily high capitalization of its undoubted gilt-edged character, and because an investment trust, enjoying safety in diversification, cannot afford to pay more than a reasonable market rate in the case of any one security. On the other hand, there are occasions when prices of speculative or quasi-speculative issues are so relatively depressed that they afford wise and profitable channels of investment within definite limits, because in the spread of holdings there is reasonable stability. The International Securities

Trust confines its purchases to what it regards as sound issues, and also takes steps to acquire these at prices affording an economic profit.

4. **ELIMINATION FROM THE PORTFOLIO OF DETERIORATING INVESTMENTS.**—The precautions in this regard are made obligatory, within maximum time limits, upon the trustees of the International Securities Trust. Such time limitations, however, are rather the exception than the rule overseas, for the opportunity of disposal under most advantageous circumstances may not necessarily arise within any definitely determined period.

So far, then, as the investment side of its activities is concerned, the International Securities Trust is built upon general lines of British experience, long followed by investment trusts in London, Glasgow and Edinburgh. In certain respects it seems more conservative in the agreement, by-laws, and practices than is ordinarily considered wise or necessary in those centers.

**Capital Structure.**—In Chapter III it has been seen that the typical British trust reserves the right to borrow, on debentures or other evidences of indebtedness, sums not exceeding the amount of its subscribed capital, and that the original "shares" are generally converted into "preferred" and "deferred stock" at the ratio of 60 to 40%. Theoretically, therefore, every £200 of capital controlled by such a trust would be composed of £100 raised by issuing debentures, £60 realized by selling preferred stock and £40 by selling common shares. With the International Securities Trust, the theoretical capital set-up is \$100 raised by issuing bonds for every \$60 in preferred shares and \$20 in common shares.

**Nature of Securities Issued—Collateral Trust Bonds.**—In one important respect the bonds so far issued by the International Securities Trust differ from those of the typical

British trust. Technically speaking, the latter are debentures, while the former are a type of collateral trust bond. Complete freedom is enjoyed in either case in altering the composition of the portfolio, but the security of the British investment trust bond consists only in its prior lien upon income and assets, and in the general policy of limiting debenture borrowing to an amount not in excess of capital derived from sale of stock, while in addition the collateral trust bond involves special pledge of collateral. The latter arrangement makes the management of an investment trust's portfolio somewhat more cumbersome, although if the trust deed is drawn with sufficient care, it carries greater assurance of safety to the investor.

The British debenture is not, however, inherently superior for investment trust purposes to the collateral trust bond. An understanding for substitution of collateral satisfactory at once to trustee and management can be embodied in the trust agreement under which bonds are issued. Thus there is coupled a reasonable facility in altering the portfolio, with the added assurance which a public unacquainted with investment trusts must necessarily feel in obligations secured by deposit of investments.

CONDITIONS OF BOND BORROWING.—The International Securities Trust has sought in four ways to approximate conditions under which it could borrow on a favorable basis. These are as follows:

1. Section 2 of Article V in the amended declaration of trust provides: "No obligation shall be issued unless at the time of the issuance thereof the value of the cash and securities (taken at the net cost price thereof) held by the Trustees hereunder shall exceed the aggregate amount of all indebtedness of the Trustees hereunder<sup>2</sup> (except that represented by the principal amount of the obligations) by an amount equal at least to one hundred eighty per cent (180%) of the aggregate principal

<sup>2</sup> Including "bond interest reserve fund." See (4) below.



amount of such Obligation and all other Obligations at the time issued and outstanding."

2. In its agreement with the trustee for its bonds (The Guaranty Trust Company), the trust covenants that the market value of collateral securing the bonds shall always be maintained at a minimum of 115% of the par value of the bonds outstanding. The trustee only authenticates new issues of the bonds when collateral providing this margin is actually deposited with it in sufficient amount to cover all of the new issue. If the market value of deposited securities at any time falls below the 115% margin, the bonds are technically in default and deposit of further securities is required. The Guaranty Trust Company is required to make independent check of current market value of hypothecated collateral; while every new issue of bonds under this trust agreement necessitates such a step.

3. It is further stipulated that when \$1,000,000 or more of bonds are outstanding, the underlying collateral shall always be so diversified that at least four hundred different issuers are represented; while not more than 10% face value may be securities of any governmental authority, and not more than 3% securities of any private issuer

4. After payment of interest on the bonds and before meeting the preferred dividend, the trust binds itself to set aside semi-annually 15% of remaining net earnings as a "bond interest reserve fund" to be deposited with the trustee for the bondholders until such time as a special reserve has been accumulated equivalent to five years' interest.<sup>3</sup> This reserve must be thereafter so maintained.

**The Preferred Shares.**—As is the case with most of the British trusts, preferred shares of the International Securities Trust are issued only in conjunction with common. This end is not accomplished, however, as with the British trusts, by

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<sup>3</sup> It is stated that the issue of bonds carrying the special collateral trust features (2 and 3) will shortly be discontinued; and that a bond will be offered protected by the fundamental provisions (1 and 4), and resembling more closely the British investment trust debenture.

"splitting" original "shares" into agreed ratios of preferred and "deferred," but by marketing shares in units carrying one share of preferred (par value \$100) and a half share of common (no par value). The preferred shares of the trust are issued under the following conditions:

1. The market value of the trust's net assets, after all indebtedness has been deducted, including the "preferred share dividend reserve fund," must exceed by at least 25% the par value of preferred stock outstanding and then to be issued.

2. Such net assets, taken at their cost value, must exceed by at least  $33\frac{1}{3}\%$  the par value of preferred shares outstanding and then to be issued.

3. When the proper amounts have been set aside for interest on bonds, for the "bond interest reserve fund," and for the preferred share dividends, a sum equivalent to  $12\frac{1}{2}\%$  of the remaining net earnings must be annually put aside as a "preferred share dividend reserve"; and this reserve must accumulate until it equals ten times the annual preferred share dividend, and must be maintained thereafter at this full amount.

The following excerpt from the amended declaration of trust defines the conditions under which holders of preferred shares may exercise voting powers:

So long as dividends at the rate per annum prescribed by the Trustees for each series of Preferred Shares, respectively, shall be paid thereon as herein provided, the holders of the Preferred Shares shall not be entitled to vote for the election of Trustees nor, except as otherwise herein specifically provided, shall any voting power whatever on any question be vested in the holders of the Preferred Shares; but in the event that dividends on the Preferred Shares at said rate per annum shall not be paid during any calendar year and such default shall not have been made good during the next ensuing calendar year, then and in such event the holders of the Preferred Shares, until such default shall have been cured, but no longer, shall have and may exercise full voting rights upon such shares held by them to the same extent as if the foregoing limitations upon said rights had not been established. The holders of Preferred Shares, however, may vote

upon any question submitted to the shareholders, provided that they shall have been requested so to do by the Trustees.

**Common Shares.**—The holder of the trust's common shares is in a position analogous to that of the owner of common stock in any corporation. He elects the trustees, and exercises voting powers ordinarily ascribed to common stock. Moreover, in preceding paragraphs it was shown what maximum ratios the capital raised by borrowing and by sale of preferred shares must bear to that derived from the sale of common. The provision that assets, at cost, minus all indebtedness other than bonds, must be at least 80% in excess of the par value of the latter, permits the trust to borrow an amount but slightly (i.e., 25%) in excess of its share capital. Similarly, the above-mentioned provisions affording a margin of protection for preferred shareholders require that at least one-fourth of all capital raised by sale of shares should represent the contribution of common stock holders.

Common stock of the trust is entitled to any net earnings after deduction of bond interest, preferred share dividends, and the special reserve funds accumulating for both. The latter make obligatory, before any dividends are payable on common shares, the setting aside of minimum semi-annual amounts accumulating until the totals of these two special reserve funds reach five times the annual bond interest requirements, and ten times the annual preferred share dividend respectively, or, in other words, until the funds so constituted are equivalent to approximately 40% of the entire outstanding capital on the assumption that bonds, preferred shares and common shares are issued in the ratios described.

In the standard capital set-up toward which the trust is at present working, \$100 is raised in bonds for every \$60 in preferred and \$20 in common. That is, of the entire capital, some 56% would represent the contribution of bondholders, 33% the funds raised by sale of preferred, and 11% the funds raised

by sale of common. When the "bond interest reserve fund" reaches five times the annual interest, an amount approximately equivalent to 30% of the face of the bonds will have been set aside, or roughly, 17% of the entire capital. When the "preferred dividend reserve fund" reaches ten times the annual preferred dividends, at, say,  $6\frac{1}{2}\%$ , an amount approximately two-thirds of the face of the outstanding preferred will have been set aside, or roughly,  $21\frac{1}{2}\%$  of the entire capital. These two funds, therefore, will represent nearly 40% of the entire capital, or about three and a half times the amount raised by sale of common shares.

As a matter of fact, on the present basis of sales of bonds, preferred and common shares of the International Securities Trust, it will be some time before the proportion of capital contributed by common shareholders is as low as that provided for in the standard ratios.

**Earnings on Common Shares.**—At first blush it might appear that holders of common shares in the International Securities Trust would have to wait a considerable period for their dividends if these special reserve funds are segregated, and if there are also set aside every year such additional amounts as a conservative policy of reserve accumulation would dictate. While fortifying the position of the common shareholder and ultimately increasing his dividends, these deductions from revenue would leave little or no current net earnings were it not for the fact that profits realized on turnover are written into current revenue, in the same way as the purely investment income, and are thus utilized to a considerable extent in the building up of these special and general reserves. The management of the International Securities Trust maintains that a yearly average of from 10 to 12% can be earned, on its entire invested capital, of this from 6 to 7% representing the purely investment return and the remainder the realized gains on turnover. The importance of borrowed capital to the common



shareholder is evident in comparing the above expected return on the entire invested capital with the cost of that portion of it represented by bonds and preferred shares issued by the trust in the proportions earlier described.

**Relation of International Securities Trust with its Fiscal Agent.**—Rather unusual contracts for the raising of its capital and the management of its portfolio exist between the Trust in question and its fiscal agent, the American Founders Trust. The latter, which is also a Massachusetts trust, was created for the purpose of organizing and managing the International Securities Trust, and other investment trusts at a later time. It is not, therefore, an investment trust in the strictest sense, but might perhaps more properly be designated by the title “an investment trust for investment trusts.” This has reference not primarily to the fact that the American Founders Trust stands responsible to the trustees and officers of the International Securities Trust for the investment and reinvestment of the latter’s funds, but to the circumstance that it possesses a considerable portfolio of its own, managed according to investment trust principles, and that an ever-increasing proportion of its assets is in the shares of investment trusts. Although constituted in an entirely different way, the American Founders Trust, so far at least as its managerial services for investment trusts are concerned, may perhaps ultimately be compared with the London and Edinburgh firms of accountants and investment bankers which administer jointly the affairs of the several trusts in their respective groups.

**The Raising of Capital.**—By virtue of its exclusive contract with the International Securities Trust, the American Founders Trust enters into agreements with bond houses and investment bankers, particularly in the large cities of eastern United States and New England, for the distribution of the bonds and share units (a share of preferred coupled with a half share of common) of the former. All commissions on



sales are paid by the American Founders Trust, which turns over to the International Securities Trust for immediate investment the entire amount of the public purchase price.

**Options on Common Stock.**—The compensation of the fiscal agent for its services and outlays in distributing bonds and shares of the International Securities Trust of America consists in options to acquire common stock of the trust, in amounts proportional to capital thus raised for it, at the original issuing price of its common stock to the public. As the unexercised options increase in value with rising dividend rates and market values on the trust's common shares, it would seem to the advantage of the fiscal agent to exercise the utmost skill and care in its services for the trust, and thus increasingly to share in the profits it is helping to create.

This principle is not unlike that commonly applied in the issue of "founders shares" or stock bonuses for the management, except for the fact that these options to purchase common stock are only granted in proportion to the sales of bonds and share units of the trust, effected through the efforts and at the expense of the fiscal agent, and can only be exercised, as mentioned above, by the payment of an amount equivalent to the original issue price of common to the public.

**Protection of Common Stock in the Exercise of Options.**—The exercise of options acquired, as previously described, by the American Founders Trust is conservatively restricted, and according to contract they will be taken down over a considerable period of years. This contract with the International Securities Trust has introduced safeguards against the weakening of its common shares by a possible sudden capitalization of the fiscal agent's rights. Moreover, the latter's options may increase in value as they are retained among its assets and this circumstance tends to encourage the fiscal agent to keep from the market the shares it acquires under options.

**A Close Bid and Asked Market.**—The bonds and stocks of the International Securities Trust are not as yet listed on the exchanges. Daily “bid” and “asked” quotations appear, however, under the caption “Investment Trusts” in leading New York and Boston papers. Some six or seven other companies are listed under this heading, several of them being “bankers share” companies, or financing investment trusts. A close market is maintained for the International Securities Trust’s securities by its fiscal agent in co-operation with approximately one hundred distributing houses.

**Management of Portfolio.**—In addition to raising the capital of the International Securities Trust, the American Founders Trust also manages the former’s portfolio in accordance with the general principles discussed in Chapters V and VI, but always under the direction of the former’s trustees. The compensation for this service is fixed at an annual percentage of the trust’s gross income. Increasing attention is being paid to foreign purchasing, and a staff of statistical and analytic experts, several of foreign nationality, is being created by the American Founders Trust to answer the peculiar needs of large scale investment trust administration, and to enable the latter to undertake similar service for other investment trusts on a purely commercial basis.

## CHAPTER XVI

### RECENTLY ORGANIZED AMERICAN INVESTMENT TRUSTS

**Two Main Types.**—Within the variety of recently organized investment trusts in the United States there may be differentiated two broad types—those creating distinctive new securities; and those applying in simpler fashion the common basic principle of joint ownership and management of diversified portfolios. The former issue shares, and it may be bonds as well, carrying the usual legal rights; although, broadly speaking, the shareholders are fundamentally owners of the portfolio, their claim is somewhat complicated by the interposition of an issuing authority, i.e., the investment trust, which, on the one hand, stands responsible to the holders of its stocks and bonds, and on the other hand, owns outright the securities acquired as investments. The latter issue only participating certificates or beneficiary shares of one kind or another, manage the investments purchased with the money of certificate holders, and reserve to the latter the option of surrendering their rights at any time in exchange for the current pro rata value of their shares or certificates. In the former case the share or bondholder may sell his investment trust securities to another, and thus, as with the owner of any corporate stock or obligations, receive their cash value by utilizing the existing market for such issues. In the latter case the investor actually withdraws from the joint fund, and receives cash, representing the immediate market value of his share of the joint investments, whether or not others take an equivalent participation at the same time being a matter of no concern to him.

**Stock Conversion Trusts Compared and Contrasted.**—The reader will recognize at once certain similarities between the

stock conversion trust, or bankers share company described in Chapter XIV, and the latter type of American investment trust. In each case the security held by the public is a participating certificate carrying direct proportional claim upon a quantity of deposited investments or an investment fund. In neither case is borrowing power utilized by the issuance of bonds. When the owner of bankers shares has accumulated an amount equivalent to an entire deposited unit, he may present these and receive in exchange from the trustee the securities collateralised; while the right of conversion, or withdrawal, is reserved at all times in investment trusts of the type in question. The differences, however, are even more characteristic than the similarities. The bankers share companies offer generally a very limited diversification; their investments are immobilized and unchangeable in the hands of trustees; and they are merely convenient means of effecting conversion operations, being otherwise entirely inactive and free from any managerial responsibilities. Companies of the kind we are now discussing are, on the other hand, investment trusts in that they conform to the definitions given earlier, and more specifically, diversify widely as a rule at the same time that they assume continuing and complete managerial duties in connection with their portfolios.

**Investment Trusts Acting Solely as Joint Management Agencies**—THE INVESTMENT MANAGERS COMPANY.—This is a joint stock association organized under the General Associations Law of New York State. It has been referred to sufficiently in preceding chapters to have enabled the reader to conclude in what ways it differs fundamentally from the British investment trusts. These distinctions are clearly set forth in the following quotation from a recent prospectus of the company:

Investment Managers Company has been organized to afford investors the advantage and protection of sound investment management applied to that portion of their resources which they wish to

have invested for the greater part of the time mainly in a diversification of common stocks:

- (1) By providing an investment plan in which a proper relation is established between current income and increase of principal, over a period of years, ignoring temporary market fluctuations.
- (2) By examining various industries and selecting the most desirable.
- (3) By appraising the character of management and earning capacity of the leading companies in these industries.
- (4) By watching for changes both in the condition of the industries as a whole and in the character of management and earning power of individual corporations, and by changing investments to accord with sound analysis of the latest available information relating to these factors.
- (5) By noting changes in financial conditions which may indicate that the larger part of an investment in common stocks should be placed temporarily in bonds and other maturing obligations, until conditions again favor common stocks.

Sound investment management retains under all circumstances diversification by industries and by securities as its fundamental principle, but establishes reasonable limits to diversification in order to permit effective supervision.

It should be recalled in this connection that the Investment Managers Company emphasizes the wisdom of investment in selected common stocks over a period of time, thus applying practically the principles enunciated by its President, Edgar Lawrence Smith, and briefly described in Chapter VI. For this reason primarily, it issues only "Investment Trust Certificates," the President of the Company commenting as follows on the ordinary practices of investment trust borrowing in a letter to the author dated August 26, 1925:

As one of our objects was to protect investors against the long-term speculative attributes of bonds and preferred stocks in connection with changes in the general price level and the general level of interest rates, we were stopped from considering the usual procedure of issuing debentures and preference shares.



In the same letter, however, it is stated that the Investment Managers Company intends ultimately to form other trusts "to meet differing investment needs."

**No New Security Created.**—By examining the nature of the "Investment Trust Certificates" issued it becomes evident that the Investment Managers Company is not attempting to create a new security, but rather merely to apply investment management to the funds of individual investors. The terms under which the certificates are issued are quoted in Chapter IV, and may here be summarized as follows:

1. The capital contributed to the joint fund by the certificate holder is managed by the Investment Managers Company under a contract between the former, the company, and the trustee with whom the investment trust fund is deposited.

2. The certificates are registered and non-transferable.

3. They may be redeemed at the will of the subscriber or of the company in exchange for either their current value in cash, or "a proportionate part of each of the investments held in the Investment Fund, with adjustment of fractional interests," at the option of the company.

4. The certificate holder is entitled to an annual 5% distribution on the face value of his certificates, payable out of net income derived from interest, dividends and profits realized on turnover. In addition, he enjoys proprietary rights as owner of a stated number of shares in the investment fund, "being the number that the amount of his subscription entitles him to receive on the day that the Certificate is issued, based on the actual value of the Investment Fund at that time." These proprietary rights are evidenced in a further distribution, after each calendar year, of 12½% of the certificate holder's proportionate part of all income derived from the investment fund when the prior payment of 5% has been made; and in the equity, which may be realized at any time, and which is presumably fortified by the policy of accumulating reserves.

5. The compensation of the management, which has also been described, consists in (a) 1% on the face value of the certificates when issued, which is added to the cost of the certificates; (b)  $\frac{1}{2}$  of 1% annually on the market value of the investment fund; and (c) 1% on the actual value of the certificates at the time of their redemption. The indenture provides that "neither the company nor its directors nor firms of which they are members may have dealings in respect of the investment fund as principals in the purchase or sale of securities."

**Principles Applied in Portfolio Management.**—The principles applied in the management of the investment fund can be no more succinctly stated than in the following quotation from a leaflet issued by the Investment Managers Company in description of the investment trust certificates, series A:

The amount of the face value of each Investment Trust Certificate will be deposited without deduction in the Central Union Trust Company of New York, as Trustee, and will become a part of the Investment Fund, subject to the provisions of the Investment Trust Indenture which include the following restrictions as to investment:

The Company shall have absolute control and management of the Investment Fund, except as herein otherwise specifically provided, and the Company shall cause the Investment Fund to be invested and reinvested from time to time as the Company may in its absolute discretion deem to be for the best interests of the Investment Fund, subject only to the following restrictions:

- (a) The Investment Fund to such an extent as it may be invested in common stocks of corporations from time to time shall not be invested at any one time in the common stocks of more than twenty (20) corporations.
- (b) The Investment Fund shall not be invested in the Securities of any corporation:
- (1) Unless at the time of such investment the Securities in which such investment is about to be made shall be regularly listed on the New York Stock Exchange, and unless sales of such Securities shall have been recorded on said Exchange during each of the twelve months preceding the

- date of such investment. (For this purpose in the case of a reorganized corporation there may be included the Securities of the predecessor of such reorganized corporation.)
- (2) If through such investment an amount in excess of 20% of the aggregate actual value (as hereinafter in Article V hereof determined) of the shares represented by outstanding Certificates would be or become invested in Securities of any corporation or corporations whose operations fall primarily within any single industry. (The determination of the Company, as to the classification of Securities by Industries shall, however, be conclusive.)
  - (3) If through such investment or otherwise the Company shall control more than 10% of the outstanding voting stock of such corporation.
  - (4) If the total capital stock of all classes issued by such corporation and outstanding, valued on the basis of the last reported sales, respectively, for each class of such stock, shall be less than \$20,000,000.
  - (5) If through such investment the market value of the Securities of such corporation held in the Investment Fund would exceed 10% of the aggregate actual value (as hereinafter in Article V hereof determined) of the shares represented by outstanding Certificates.
  - (c) The Investment Fund may be invested from time to time, to such extent as the Company may in its absolute discretion deem advisable, in Tax-Exempt Securities, and/or obligations of the United States of America, and/or in call and/or in time loans upon collateral security consisting of stocks and/or bonds listed upon the New York Stock Exchange having a value at the time of the making of any such loan of not less than 20% in excess of the amount of such loan.

Paragraph (a) limits diversification in order to permit effective supervision. Paragraph (b) (1) insures marketability and excludes new and inactive issues; (2) insures diversification by industries; (3) protects the disinterested investment viewpoint; (4) avoids corporations with insufficient financial backing; (5) insures diversification both as to securities and industries. The Investment Trust Indenture may be amended only as therein provided.

ADVANTAGES AND DISADVANTAGES.—The Condition and Income Statements of "Investment Trust Fund A" of the

Investment Managers Company, as of June 30, 1925 are given in Appendix K, from which it appears that by the middle of 1925 the aggregate face value of outstanding certificates, which were first issued on January 13, 1925 was \$2,189,900 (representing 218,688 shares), while the actual value of the investments was \$2,259,581.19.<sup>1</sup> It would seem that this money is being invested under a simple and flexible arrangement, permitting investors to acquire shares when they wish, and to redeem them when desirable. Only one type of certificate is issued, there being no debts incurred by the fund and no junior securities to absorb the equity.

As contrasted with the ordinary type of investment trust, the Investment Managers Company maintains, generally, a far larger proportion of common shares among securities deposited for certificate holders, and it must for this reason exercise unusual diligence in evacuating unsafe positions on the eve of general business declines and falling dividend prospects reflected in "bearish" movements on the exchanges. While something may, no doubt, be said in favor of the point of view that well selected common stocks, with their claims on business profits, are in the long run a better investment than exclusively prior-lien securities, it should not be forgotten that any well run investment trust has freedom to shift from fixed yield to dividend-bearing holdings as changing conditions warrant, and that fluctuations in the current market values of all kinds of securities open opportunities to realize profits on turnover (See Chapter VI).

The arrangements for putting aside 87½% of all net earnings after payment of 5% on the face of the certificates is highly commendable. We have seen that the building up of strong reserves is a basic principle of sound investment trust management, and is generally applied in investment trusts of all types. The fact that no loans are effected by the Invest-

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<sup>1</sup> Face value of certificates outstanding as of December 31, 1925, was \$4,506,100. At this time, 63.2% was invested in call loans, cash and receivables, and only 36.8% in American common stocks (6 railways, 2 public utilities, and 6 miscellaneous).



ment Managers Company is no doubt an element of security for the certificate holders, but in the long experience of British trusts it has been conclusively shown that the exercise of borrowing powers, when surrounded by the proper safeguards, is a very important source of additional profit to the common shareholder.

In offering to the public only certificates of the kind described above, the company is consistently applying the theory that securities of fixed yield are in the long run a less desirable investment for the average person; and it would appear that by the exercise of considerable ingenuity a beneficiary share has been created which combines some of the advantages of common and preferred stocks, without, of course, the margin of protection ordinarily enjoyed by the latter through the capital subscribed via the former. The ordinary investment trust, however, is merely offering the different kinds of securities to which the public has long been accustomed, a bond which should, and generally does, possess unusual strength; a preferred stock; and a common stock which is as secure as the underlying portfolio. It is unlikely that the time will ever come when the investment trust bond is not peculiarly qualified for certain investment needs; while the common shares will always be available for those who wish to acquire them.

**The Alwyn Corporation.**—Like the Investment Managers Company, the Alwyn Corporation issues "investment trust certificates," and supervises the investment and reinvestment of funds derived from sale thereof to the public. These funds, whether in cash or securities, are held by the Empire Trust Company, in which the legal title is vested, while "each security is in negotiable form and registered in the name of the trustee and all cash, dividends and interest are paid to and held by the trustee for the benefit of certificate owners."

The certificates (Series A), representing participating ownership in the deposited cash and securities, are issued in



denominations of \$100, or multiples thereof, and, like the certificates issued by the Investment Managers Company, are redeemable at a figure equivalent to the pro rata share in the investment fund, including accumulated reserves. Assignment of certificates is not permitted, but redemption rights are made assignable, thus facilitating borrowing on the certificates in lieu of redemption.

Redemption value, as well as price per participating share, is determined in the following manner :

The price of each share represented by a Certificate is fixed and definite, being based in every instance on the amount of cash and the market price of securities in the Investment Trust. The price of a share is ascertained in the following manner: to the amount of cash in the Investment Trust is added the total value of securities based on their market prices and then the total is divided by the number of shares outstanding. The management will determine the actual value of shares at the close of business each day and will inform Certificate Owners of this value upon request.

Other points of resemblance with the certificates issued by the preceding company are the distributions to certificate holders, and the compensation for management, which are best described in the following paragraphs from the prospectus issued by the Alwyn Corporation in December, 1925 :

*Distributions to Certificate Owners.*—Distributions are cumulative and payable at the rate of 5% per annum quarter-yearly on December 1st, March 1st, June 1st and September 1st. Extra distributions may be paid from time to time in the discretion of the Board of Directors of the Corporation either from income or principal, and it is expected that the annual return to Owners of Certificates from income should exceed the fixed return of 5% per annum.

*Management Compensation.*—The Corporation receives for all services under the terms of the Trust Indenture the following: Upon the sale and issue of Certificates 1% of the purchase price, to be paid by the purchaser in addition to the purchase price; upon redemption 1% of the redemption price;  $\frac{1}{8}$  of 1% quarter-yearly on the actual value of the Investment Fund; 10% annually of the net income of the Investment Trust for the preceding calendar year. Out of these

payments the Corporation is required to pay all expenses incident to the management of the Trust, including compensation to the Trustee, the accountants, salaries to officers and employees and other office expenses, printing, advertising and marketing the Certificates."

Securities to be purchased for the investment fund are selected by the directors of the Alwyn Corporation, acting within certain broad limitations specified in the trust indenture (such as the provision against placing more than 20% of the entire fund in securities of any one corporation, or more than 10% in foreign government bonds, or more than 5% in the bonds of any one foreign country). Complete discretion is lodged with the directors in altering the composition of the investment fund in the interest of greater safety of principal, higher return or prospective capital profits. On December 9, 1925, the investment fund comprised ten securities, including seven common stocks, two preferred stocks, and one bond—all in American companies. The diversification, therefore, was at this time very limited.

**The Alexander Fund.**—Similar in some respects to the investment trust certificates offered by the Investment Managers Company are the "units" issued in periodic series to participants in the so-called "Alexander Fund." This is an unincorporated agency registered with the Pennsylvania State Banking Department and built about the personality of its founder, who, since 1907, has accepted funds for joint investment, first from an immediate circle of friends and subsequently from an increasing number of investors. In set-up and operation this Fund represents the investment trust in its simplest or most primitive form, and its organization and methods of operation may be briefly described as follows.

Twice annually the Fund issues participating "units" in a new series, alphabetically designated. These units are in denominations of \$100, and are sold at par when first offered. The funds so derived are immediately invested, whether prices

prevailing for securities are high or low at the time—the purpose of these periodic issues, according to the management, being to enable an investor, by acquiring shares at regular intervals, to participate in purchases effected during all phases of the credit cycle. The following is quoted from a recent statement made by the manager of the Alexander Fund:

The main reason, however, for the serial issues is to influence participants to invest under all market conditions, whether high or low. The average investor buys mainly when conditions appear good and prices are high, consequently he secures the least for his money. But the trained investor buys at all times, even when conditions seem unfavorable. Subscription to each new series gives a good average investment over a period of years, as moneys received by a new series are used at once to purchase securities at the then market level.

The investments made with the proceeds of these different issues are handled as a common fund, each series being given its proper claim upon the pool as determined by market prices of investments obtaining at the time of offer. An investor may secure additional units of any series at their current value if this is above par, while a unit owner may at any time withdraw from the Fund by offering his shares for redemption at their then value.

Investments of the Fund, which in July, 1925, had some 460 participants, are currently valued at about \$1,500,000 and represent an original investment of \$1,140,000. The portfolio has some 140 distinct investments, which are for the most part listed on the principal exchanges, and include bonds and stocks of banks and financial institutions, and of corporations engaged in all the main lines of the nation's business. Investment in any one security as a rule does not exceed 2.5% of the total. Income is derived from interest and dividends on securities held, and from profits made in reinvestment. Distribution rates, which are initially fixed at 6%, are moved upward if and when the condition of the fund permits it; and the rise in the rate is by stages as the current values of the units in the several

series reach different points in their upward movement. What remains after distributions accumulates in the fund for the benefit of participants, and the fund has no debts of any kind. It is of interest to note that Mr. Alexander has also a "Securities Fund," which is thus described in a recent prospectus:

In two years and four months this Fund has made a profit of 60 per cent on its capital, or at the rate of 25 per cent per annum. We cannot promise such results always, but we do believe that for those who do not require regular income, the Securities Fund affords the finest type of investment. The income is allowed to accumulate and is reinvested. No dividends are paid, and the Manager receives no compensation until a participant withdraws, when the usual commission is deducted from the withdrawal figure. All securities are owned outright. Participation in this Fund may be had in multiples of \$1,000.

Management of the Alexander Fund, as mentioned above, is largely a personal matter. Five "overseers" are appointed by the manager from among the participants, and they are kept fully informed of the affairs of the fund. In the event of the manager's death they are authorized to choose his successor. The compensation for management consists solely of commissions charged on all distributions.

**Recapitulation.**—We have been dealing with three investment trusts which, in a sense, are not creating a new security, but whose issues represent a direct pro rata claim upon a jointly constituted and centrally managed investment fund. The certificates, shares, or "units" owned by participants may be redeemed at the option of the holder or of the management, at their current conversion values. No debts are contracted by the fund, and but one type of participating certificate is offered. Among the advantages of this simpler species of investment trust are the right of withdrawal at any time enjoyed by the beneficiaries or participants, and such added assurance as the lack of funded debt may carry. Among the disadvantages are that these withdrawal or conversion rights may be exercised at critical periods, when the trust would perhaps be compelled



to liquidate its more marketable investments at sacrifice figures;<sup>2</sup> that by not utilizing borrowing power, an important potential source of earnings is left aside; and that the certificate holder possesses no voting rights such as ordinarily belong to common shares.

**Investment Trusts of a More Formal Type.**—Between trusts of the type we have just been considering and those which operate in every way like corporations, there are several American varieties resembling in certain respects the first, and in other respects the second, of the two main categories described at the outset of the chapter. These will be briefly considered in the approximate order which their general resemblance to one or the other category suggests.

Although its certificates are not redeemable at the option of the owner, the Securities Trading and Holding Corporation, organized under the laws of Delaware in 1925, is comparable to the foregoing in the one circumstance that the "investment trust shares" issued by it are directly related to the investment fund, which in this case, as with the Investment Managers Company, is held by a trust company. It is stated in the prospectus of this new undertaking:

The principal capital asset of the Corporation, upon completion of the present financing,<sup>3</sup> will be a Million Dollar Trust Fund, represented by a wide diversity of high grade investment securities. The Corporation will realize a sum in excess of the above mentioned Trust Fund. This balance represents the invested surplus of the Corporation. A portion of the Annual income will be applied to Surplus and Reserve, thus increasing the asset value of the outstanding Shares year after year in accord with the best banking and investment practice. . . .

The interests of the stockholders in the Corporation are safeguarded by a Trust Agreement between the Corporation and the Prudential Trust Company, Limited, Trustee and Depository. This agreement requires the Corporation to deposit with the Trustee in a Special

<sup>2</sup> The reader will recall, however, that the Investment Managers Company reserves the right to redeem its Certificates either in cash, or in an actual distribution of securities.

<sup>3</sup> 100,000 "Investment Trust Shares" of no par value, offered at \$12.50 per share. The Prudential Trust Company, Limited, of Montreal, Canada, serves as trustee and depository.



Trust Fund \$10 a share against the issuance of its Investment Trust Shares. The Trust Agreement thereby establishes a Million Dollar Trust Fund which is invested and reinvested by the Trustee under the direction of the Finance Committee exclusively in securities which have been approved by the Board of Directors in conformity with the rigid restrictions as provided in the Trust Agreement. The Trustee is required to certify on each certificate for these Investment Trust Shares that a sum equal to \$10 a share has been deposited in a Special Trust Fund, to be invested for the benefit of the shareholders of the Corporation, subject to the restrictions of the Trust Agreement. At any time the sum of the market value of the securities and the cash deposited shall exceed \$10 per share for all outstanding shares, this excess amount may be withdrawn by the Corporation and appropriated for dividends, or Surplus and Reserve Accounts. The Trust Agreement definitely provides, however, that no withdrawals may be made from the Trust Fund which would reduce the Trust Fund below this amount.

The paid surplus and earned reserves, it would seem, are to be directly under the control of the issuing corporation, and it is stated in the prospectus just quoted that every share carries full voting power. Investments are to be so diversified that at least one hundred different securities will be found in the portfolio, and stocks and bonds are to be held which are representative of every major industry. The standards of investment provide against majority interests in any undertaking. Among the provisions for diversification, which contain interesting geographical limitations, appears the requirement that not more than 5% of the assets of the Securities Trading and Holding Corporation may be invested in any one issue. Earnings are to be derived from the investment return on the "Million Dollar Trust Fund," as well as the surplus or reserves, and from the profits realized in the reinvestment of the fund held in trust. It is not known what proportion of the difference between \$10, which is deposited in trust, and \$12.50 for which the shares are sold the public, goes into marketing outlays and promotion profits.

**The New England Investment Trust.**—This is a corporation which like the Investment Managers Company emphasizes the wisdom of common share investments. Stocks of eighty companies are deposited in blocks of 121 shares with a Boston trust company. Against each of these blocks there are issued 1,000 "collateral trustee shares," for the holders of which the trustee collects dividends on the deposited shares. The declaration of trust provides that not more than 5% of the total investments may be in shares of any one company. The following quotation explains the conditions governing turn-over:

If any stock in the unit should have a market appreciation of 25% or more over the price of acquisition and the Trust is of the opinion that profits should be taken, it may instruct the Trustee to sell such shares and reinvest the proceeds in those shares still remaining in the unit; or in the shares of another company in the same classification, which shares must be listed on either the New York or Boston or Chicago Stock Exchange, and such company must be in perfectly sound condition and has paid dividends for at least five consecutive years prior to the date the stock is purchased; or it may reinvest the proceeds in the same company whose shares were sold, provided, however, that said company is eligible under the foregoing rule and the shares can be acquired at a lower price than the price for which they were sold.

If at any time any company, any of whose stock is held by the Trustee under the agreement and declaration of trust, should fail to pay dividends for one year, or, if at any time the Trust shall receive information that in its opinion would warrant the conclusion, that dividends will cease temporarily or permanently, or that such stock will become substantially impaired in value, then the Trust shall have the right to sell such stock and either reinvest the proceeds, or any part thereof, in the purchase of stock of the same class as already included under said agreement and declaration of trust of any one or more of the companies enumerated herein or in the shares of financially sound corporations which have a record for the payment of dividends for not less than five consecutive years, and all such additional stock purchased and all cash proceeds shall be held by the Trustee for and on behalf of the registered holders of collateral trustee share certificates.

All profits realized from the sale or purchase of any of the shares so deposited shall be reinvested only as above provided, and there can be no other substitution.

As with stock conversion companies, the dividends paid on certificates depends upon the current income derived from deposited shares, and the sale of any stock dividends or subscription rights. No provision appears for accumulation of reserves.

**The Bond Investment Trust.**—This undertaking, which was established in 1923, and is controlled by Harris, Forbes and Company, Boston, issues no capital stock, but had, in August, 1925, "certificates of beneficial interest" outstanding in excess of \$800,000. These certificates are in denominations of \$100 and multiples thereof, and they carry no voting power. The Bond Investment Trust, being a Massachusetts common law trust, its trustees hold all the funds as legal owners, and although self-perpetuating, are strictly accountable for the administration thereof in accordance with the declaration of trust. The powers of investment, to which reference has been made in Chapter V, are confined to securities of the obligation type, and complete freedom is reserved to the trustees to alter the composition of the portfolio. Although the power to borrow is reserved in the declaration of trust,<sup>4</sup> it has not as yet been utilized to acquire further investments. In January, 1925, some forty different bonds appear in the portfolio, of which three are obligations of foreign governments and the rest domestic public utility issues.

Dividends paid to holders of the "certificates of beneficial interest," which are at present on a 5% basis, are determined by the trustees as described in the following excerpt from the declaration of trust:

<sup>4</sup> The following is quoted from this instrument: "*Power to Borrow and Pledge.*—The Trustees shall also have power at any time to borrow money, and to pledge, as collateral security for such loan, any personal property belonging to the Trust Fund provided, however, that no loan shall be contracted for, so that the aggregate amount of such loans outstanding shall at such time exceed, in the judgment of the Trustees, 25% of the total amount of the personal property of the Trust Fund."

## DIVIDENDS—SURPLUS

The Trustees shall declare dividends from the net income of the Trust Fund among the holders of certificates of beneficial interest semi-annually or oftener, if convenient to the Trustees, and their decision as to amount of dividends and as to using therefor any portion of the Surplus Fund shall be final. They may set aside from time to time such portion of the net income as shall not be required for dividends for a Surplus Fund.

## POWER TO DECIDE BETWEEN INCOME AND CAPITAL

The Trustees may charge all brokers' and agents' commissions, and the expenses of organization of the Trust, to Income or Capital, as they see fit. They shall have the right to treat as income such portion of the price of securities bought or sold between dividend days as fairly represents accrued dividends reckoned by way of interest. In general their decision as to what constitutes Capital or Income, or shall be credited or debited to Capital or Income, shall be final.

The operating expenses of the Trust are paid out of the surplus fund; and the compensation of the Trustees is limited to not more than 5% of the gross income, and "1% of the amount distributed or conveyed upon final distribution or conveyance."

Somewhat similar to the Bond Investment Trust, at least in the type of securities it purchases, is the Bondshare Corporation, which in other respects, resembles the bankers share company described in Chapter XIV. Securities offered by this company are known as "bondshares," and they are secured by deposit of railroad, public utility, industrial and foreign bonds with a trust company. It is provided that "when and after 400 bondshares are outstanding no one group of bonds, namely, railroad, public utility, industrial or foreign, shall comprise more than 35% face value of all bonds deposited with the trustee, and no one deposited bond shall represent more than \$5.00 of the value of a bondshare" (\$98).

**The Massachusetts Investors Trust.**—Like the Bond Investment Trust, the Massachusetts Investors Trust, organized



in March, 1924, is a common law trust of that Commonwealth, and the shares (par value \$50) have no voting rights. The investment powers of the trustees are, however, much wider, as will be evident from a perusal of the following articles appearing in the agreement and declaration of trust:

ARTICLE III. SECTION I. The Trustees in all instances shall act as principals, and are and shall be free from the control of the Shareholders and have the right and are empowered hereby, in their absolute and uncontrolled discretion, to do any and all of the following acts:

(a) To buy, and invest the funds in their hands in, bonds, stocks, notes, certificates of indebtedness, mortgages, acceptances, certificates of interest, and other negotiable securities, however named or described, of the United States Government and of foreign countries, of States, Counties, Cities, Towns or Districts, of Governmental Agencies, or of Corporations, Associations, or of other organizations, domestic or foreign, to the end that the investments may be generally diversified in the nature of the investment, and the geographical location thereof, and in the line of commercial activity represented thereby.

The Trustees shall not in anywise be bound or limited by present or future laws or customs in regard to trust investments, but shall have full authority and power to make any and all investments which they, in their uncontrolled discretion, shall deem proper to accomplish the purpose of this trust.

The Trustees shall be limited, however, in the purchase of a stock of any corporation to an investment which shall not exceed Five Per Cent (5%) of the capital paid in to said Trust.

(b) To sell, or otherwise dispose of, free and clear from any of the provisions of this trust and from any of the liens created by this trust, any of such investments, and to reinvest the proceeds thereof or any part thereof, with continuing powers to so invest and reinvest during the existence of the trust. . . .

The borrowing powers of the trust are defined in the following section, but only the one class of security has so far been issued:

(e) For the purposes of said trust to raise and to borrow money, with or without collateral security, and, whenever in their judgment necessary, the Trustees are authorized to pledge, mortgage, charge or hypothecate, or otherwise encumber the whole or any part of the trust



estate as security for a loan or loans, provided, however, that no loan shall be contracted for by which the aggregate amount of such loans outstanding, after the trust estate shall amount to Fifty Thousand Dollars (\$50,000), at any one time shall exceed, in the judgment of the Trustees, fifty per cent (50%) of the total value of the property of the Trust fund. . . .

The portfolio of the Massachusetts Investors Trust is mainly or wholly in common shares, and purchases are made from a published list of approved stocks including more than two hundred different securities representing three score or more industries. The list of securities given out in September, 1924, includes sixty-five different common shares, and brings this Trust into sharp contrast with the Bond Investment Trust, which acquires only prior-lien securities. The Massachusetts Investors Trust, in fact, emphasizes investment in common stocks for the same general reasons that actuate the Investment Managers Company in so utilizing funds derived from sale of its certificates, though both of these trusts reserve the right to acquire bonds and preferred shares at times when, in the judgment of the management, such purchase becomes desirable.

The provisions with respect to distribution are especially interesting, as, following British practice, a clear distinction is made between profits on turnover and ordinary investment income. The former, it will be noted, are in the first instance to be employed for accumulating reserves, which, however, may be paid out in dividends at the discretion of the Trustees:

. . . SECTION 3. The net income of the trust shall be distributed pro rata to and amongst the shareholders as dividends, annually, or oftener, as the Trustees shall determine.

The term net income shall be defined as the gross earnings of the trust fund, excluding capital gains, less:

(1) The expenses including taxes, commissions to the Trustees and other charges properly deductible for the establishment, maintenance and administration of the trust.

(2) A sum which from time to time shall be fixed by the Trustees

at not less than 2% and not more than 5% of the gross income of the year which shall be set aside as a sinking fund or accumulated surplus to be held for the purposes of the trust.

SECTION 4. The Trustees may establish a sinking fund or accumulated surplus from capital gains and from that part of the gross income set apart under authority of Article VII, Section 3 hereof.

The Trustees shall have the right, however, from time to time to declare and pay out of such sinking fund or accumulated surplus the whole or any part thereof as dividends to the shareholders.

The Trustees shall have full authority to determine conclusively all questions as to whether sums received, or property to be accounted for, is income or principal.

It is elsewhere provided in the declaration of trust that the remuneration of trustees shall be "at the rates generally current for such services in Boston," while the ordinary administrative costs are taken out of the current income. The depository is a Boston trust company, into which all moneys and other property received for the trust are paid, as well as all interest and dividends accruing on the investments.

**First Investment Company of New Hampshire.**—Incorporated in 1916, the First Investment Company, of Concord, New Hampshire, enjoys a broad charter, but it has not yet made use of its borrowing powers. Since January of 1925 the capitalization has consisted of "class A" and "class B" non-par shares. The former are a type of preferred stock entitled to priority dividends on a six per cent basis, and to a prior claim of \$50 in event of dissolution, and participating equally with the latter in any further distributions. "Class B" shares are held exclusively by the directors, while for current expenses there is set aside 5% of net income, the directors being personally responsible for outlays in excess of this amount.

The First Investment Company will have, upon completion of financing undertaken in 1925, "class A" stock to the extent of 20,000 shares outstanding (sold to the public at \$50 a share), and "class B" stock to the extent of 10,000 shares. Broad discretion rests with the directors in choosing investments, prac-

tically the only limitation being that not over 10% of the capital shall be invested in any one security. Present holdings of the company are confined to stocks of thirty-five or more American industrial and public utility enterprises, but the management is not committed to common stocks, and will shift from shares to bonds if and when conditions seem to indicate the wisdom of such a course. In the future the company will purchase only listed securities. Profit-taking on reinvestment is a settled policy of the trust, which regards gains realized on turnover as current income available for dividends and surplus. Reasonable provision is made for reserves, but no arbitrary standards have been adopted. Dividends of 6% have been regularly paid since organization, with the exception of two years, 1921 and 1922, when, despite the fact that earnings were in excess of dividend requirements, cash was conserved in view of prevailing financial uncertainties. Furthermore, a 25% stock dividend was declared in January, 1925. The management reports that average net earnings have been about 12% on the outstanding stock sold to the public since the organization of the company.

**The Wisconsin Investment Company.**—In operation since November, 1924, this company claims to be "the first British type investment trust in Wisconsin." Voting stock (\$100,000) is limited to twenty stockholders who are permitted to draw up from time to time such investment policies as appear to them sound and profitable. Not until early in 1926 was the company in position to handle funds raised by the sale of non-voting stock, an issue of \$500,000 of which was offered in February. Funds are at present distributed among about 70 different securities.

**Trusts Specializing in Shares of Financial Institutions.**—Five corporations confine their investments to shares of financial institutions. These are the Bankstocks Corporation, the Joint Stock Securities Company, the Eastern Bankers Cor-

poration, the Financial and Industrial Securities Corporation, and the Joint Stock Bond and Share Company.

**1. The Bankstocks Corporation.**—Incorporated under the laws of Delaware in 1925, the Bankstocks Corporation is restricted to investments in the capital stock of a designated list of banks and trust companies located in New York City, Chicago, Cleveland, Philadelphia and Boston. The following relevant provisions are quoted from its by-laws:

. . . . SECTION 3. Without the consent in writing or, at a meeting duly held, of the holders of at least three-fourths of the outstanding capital stock of the Corporation, the directors are hereby limited and restricted in the investment of the funds of the Corporation and in the declaration and payment of dividends as follows:

(a) No funds of the Corporation shall be invested except in shares of the capital stock of the following banks and trust companies (together with capital stock of such affiliated securities companies as are managed by or in conjunction with any of such banks and trust companies):

. . . . .  
(Here follow the names of fifty-seven eligible  
national and state banks, and trust companies)  
. . . . .

And the shares of stock of a bank or trust company into which any bank or trust company above named may be merged or with which it may be consolidated or any bank or trust company resulting from any merger, consolidation or reorganization to which one of the aforementioned banks or trust companies shall be a party, provided its capital stock and surplus shall not be less than the capital stock and surplus of the bank or trust company above named at the time the latter entered into such merger, consolidation or reorganization.

The above restriction, however, shall not prevent the Corporation from purchasing shares of its own capital stock to the extent permitted by law.

(b) No more than 10% of the total assets of the Corporation may at any time be represented by an investment in the shares of stock of any one bank or trust company and its affiliated securities company, if any, at current market prices. . . . .

The directors are given borrowing powers, subject to the following provision:

. . . . (c) No dividends shall be paid or declared which would reduce the sum of its cash and the current market value of the shares of capital stock of banks and trust companies, including affiliated securities companies, then owned by it below 150% of the total indebtedness of the Corporation. . . . .

The authorized capital stock is 150,000 shares of no-par value, which is being offered to the public at \$25 a share.<sup>5</sup> There has also been authorized as much as \$5,000,000 in five year 5% "secured gold notes," but to the present time all funds of the corporation have been derived from the sale of capital stock. It is interesting to observe that the secured gold notes will be issued, when and if advisable, under an indenture resembling in certain respects the trust agreement, described in the preceding chapter, according to which the bonds of the International Securities Trust have been authenticated. These notes are to be secured by a deposit, with the trustee for the noteholders, of securities having a market value of at least 125% of their face value.

Investments of the Bankstocks Corporation to date have been confined to twelve New York banks. The policy concerning dividends has been thus stated by the Vice-President in a letter to the author (August 19, 1925):

Investments so far made have shown an average appreciation of over 10%, but it is not the purpose of the company to take this profit through sale of the holdings. In the matter of dividends, the directors have adopted the policy of accumulating the income and surplus in order to build up a reserve and will not pay dividends until these reserves and surplus have reached a satisfactory amount. In other words, the policy is to build up values behind the stock and allow the profits to accumulate as a safeguard. . . . .

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<sup>5</sup> 25,000 shares of this no-par common stock have been offered in 1925. Of the remaining authorized but unissued shares, 87,500 will be retained for future financing, while 37,500 are earmarked "to apply against Common Stock Purchase Warrants to be issued with Five Year 5% Secured Gold Notes."

In the sale of the common shares dealers were allowed a commission of \$1.25 (5%) of which 50 cents might be passed on to financial institutions.



It is stated in the prospectus that :

. . . . Earnings from investments based on the records of the various stocks for the past ten years, not only from regular dividend receipts but from profits upon sale accruing from enhancement in value of stocks owned and extra disbursements which in the past have aggregated substantial amounts and have been disbursed at frequent intervals, should be sufficient to yield an attractive return on this common stock.

Metropolitan National Bank and Trust Company of the City of New York have agreed to act as Depositary for Bankstocks Corporation, and, as such, will be the custodian of the securities of the company and will act under the direction of the Board of Directors of the Company in the purchase and sale or other disposition of the investments in accordance with the deposit agreement, a copy of which is on file with the Depositary. . . .

**2. The Eastern Bankers Corporation.**—Incorporated under the laws of Delaware in 1922, this is another recently formed American investment trust which emphasizes the superiority of financial institution stocks as long-term investments. That the scope of its investments is somewhat wider than for the Bankstocks Corporation, however, appears in the following statement of its purposes appearing in a recent prospectus :

The Eastern Bankers Corporation is organized for the purpose of investing and reinvesting all its funds, with the exception of a small reserve, in the stocks of selected Financial Institutions. It is not a dealer in such stocks, nor does it make loans, accept deposits or engage in any other business operations. Financial Institutions as herein described, include National Banks, State Banks, Trust, Insurance, Title, Holding, Surety and Guarantee Companies. . . .

The corporation offered 10,000 shares of 7% preferred stock at \$105 per share (par value \$100), and 100,000 shares of common stock at \$12.50 per share (par value \$10), the entire capitalization being \$5,000,000 equally divided between 25,000 shares of preferred stock, callable on any dividend date at \$115 per share and accrued dividends, and 250,000 shares of common. The latter is issued for cash, or on occasion for

stock of financial institutions only at such prices as the company would be willing to pay on a cash basis. It is stated in a recent prospectus that "The Eastern Bankers Corporation is financially interested in, and three of its directors are officials of the Bankers Capital Corporation (bank stock dealers), which enables it to keep in close touch with the market for investments."

The Eastern Bankers Corporation paid its first dividend on the common stock in January, 1924, at the rate of  $1\frac{1}{2}\%$ ; in January, 1925, a dividend of  $3\%$  was paid; and the writer is informed by the management that a dividend of  $6\%$  will be declared and paid in January, 1926. Regular preferred dividends of  $7\%$  have been distributed.

**3. Joint Stock Securities Company.**—This is an investment trust of even more limited diversification than the foregoing, for the reason that the entire proceeds from the current sale of its common stock have been, or will be, invested in stocks of the Chicago, Kansas City, Southern Minnesota, Dallas and Des Moines joint stock land banks. It is a Massachusetts corporation organized on April 2, 1925, offering common stock of \$100 par value, with dividends cumulative to  $6\%$  per annum, and "deferred stock" of no-par value. There is no funded debt, and upon completion of financing the capitalization will consist of 10,000 shares of common (\$1,000,000) and 500 shares of deferred.

The common stock is entitled to cumulative dividends at the rate of  $6\%$  per annum before any dividend is paid on the deferred stock in any one year. After such common dividend has been paid, and \$6 per share has been paid on the deferred shares in any one year, plus an amount equal to  $5\%$  of the entire net earnings for the preceding year, any further dividends are to be distributed ratably among the common and deferred stock share for share.

The holders of deferred stock shall have at all times one vote for each share held by them respectively. The holders of common stock shall have one vote for each share held by them respectively if in any

year there shall be paid less than 5% in dividends on the common stock except in the year 1925.

The company has been formed "to purchase, acquire, own, sell, transfer, pledge and deal in shares of the capital stock of Joint Stock Land Banks, farm loan bonds issued by one or more Joint Stock Land Banks or Federal Land Banks, bonds or debentures of Federal Intermediate Credit Banks, United States bonds and certificates of indebtedness, and notes of individuals, partnerships or corporations secured by marketable collateral; and while owner of any such stocks, bonds or securities, to exercise all rights of ownership, including the right to vote thereon," but its *raison d'être* seems to be primarily the investment, as its name would indicate, in shares of capital stock of Joint Stock Land Banks created under the Federal Farm Loan Act and operating under Federal charter. It is anticipated that the principal income will be the dividends accruing on these investments. Several of the directors are prominently connected with the above mentioned Joint Stock Land Banks.

Borrowing power is strictly limited, as the Agreement of Association provides that—

. . . . no obligation shall be incurred for the payment of money which is payable more than thirteen months after the date thereof, or which will make the aggregate liabilities of the corporation exceed the sum of its paid-up capital, surplus and undivided earnings, unless the directors have been expressly authorized to incur such obligation by vote of the holders of two-thirds of the common stock and a majority of the deferred stock of the corporation. . . . .

#### 4. The Financial and Industrial Securities Corporation.—

This company, it is announced, will own stocks and voting trust certificates in three insurance companies, two banks, and one trust company, as well as "varying amounts of stocks in other prominent financial institutions" and "securities of diversified character." An offer of \$15,000,000 7% cumu-

lative preferred stock, with purchase warrants for Class "A" common stock, was made in January, 1926.

**5 The Joint Stock Bond and Share Company.**—This is a Maryland corporation, organized primarily to hold capital stocks of selected Joint Stock Land Banks, and to reorganize and finance such institutions. It is therefore perhaps even less of an investment trust than the other specialized investing institutions described in this section. An issue of "common capital stock (Class A)" was offered in February, 1926. This carries cumulative dividends up to 6%, and shares the net profits with Class "B" common stock, held by the management.

**Specialization in Portfolios.**—The five corporations we have just been considering represent extreme specialization in investment, by confining their portfolios to financial institutions, acquiring primarily common stocks of the foregoing, and limiting the list of eligible companies. The theory upon which they operate is that certain types of common stocks offer unusual prospects of increasing dividends and rising market values. In three instances at least several of their directors are actively engaged in banking or in bank financing. Those moderately circumstanced investors interested primarily in securities issued by financial institutions may find investment trusts of the kind extremely useful media of investment; but there is no reason to believe that such a limitation of the field covered by the portfolio will necessarily offer advantages offsetting the disadvantage of confining interests to one limited area of business. Whether this would prove the case, depends naturally upon the skill and care with which general investment trusts are run; but the reader will recall many reasons, developed in preceding chapters, for concluding that there is no *prima facie* evidence for the advantage of departing, on general principles, from standards of broad diversification, as to sphere of investment, and type of security purchased.

**The Financial Investing Company.**—Incorporated under the business laws of New York State in January, 1925, for the purpose of pursuing a general investment trust business, the Financial Investing Company for its first year of activity offered only common stock, save for the Foreign Government Bond Certificates, although the right to borrow on bonds is reserved in its by-laws. It has effected bank loans on diversified collateral, at rates 2% or so below the yield on investments made thereby. Common stock of the company has par value of \$10 and has been issued at \$15, a paid surplus being thus accumulated at the outset.

The standards of diversification are very broad as appears from the following section of the by-laws:

SECTION 2. Required Investments. The Corporation shall keep and maintain assets consisting of (1) cash, (2) bankers acceptances and/or bank certificates of deposit, and/or (3) investment securities (as hereinafter defined) of a market value equal at all times to the aggregate of the total par value of its outstanding capital stock and the total principal amount of its outstanding bonds and other obligations. . . . The Corporation may invest all other funds and assets at the time belonging to it in such securities or other property as the Board of Directors . . . may authorize or approve. Investment securities, as used herein, must be securities listed upon some recognized stock or bond exchange and must meet the requirements hereinafter . . . set forth.

Although, in other words, the Financial Investing Company shall maintain in cash, bankers' acceptances, or listed securities an amount equivalent to the par value of its issued shares and the principal amount of its outstanding bonds (if any), the reserve derived from initial sale of common stock in advance of par, as well as that later earned, may be otherwise invested at the discretion of the directors, and under such standards of diversification as they may approve. In this way it is hoped that the company will be able within very definite limits to enter a more speculative and presumably profitable field of investment, without endangering its basic capital, and the regular



income and turnover profits derived from investment and re-investment thereof.

Early in 1926 the Financial Investing Company offered 5% gold bonds, of an authorized issue of \$4,000,000. Bearer stock purchase warrants were delivered with each bond, and the obligations are issued under a trust agreement with the Guaranty Trust Company, which holds, at all times, collateral security for them, as defined in the following excerpts from the trust agreement:

1. The value of cash and securities (taken at their market value to be determined by the Trustee . . . .) pledged hereunder and then held by the Trustee, shall be at all times equal at least to 120% of the principal amount of all of the Bonds then issued and outstanding hereunder.

2. The aggregate value of the securities (taken at their market value to be determined by the Trustee . . . .) pledged hereunder and then held by the Trustee, issued by any one government, state, municipality or other governmental authority or by any one other obligor or issuer, at no time shall exceed 2% of the aggregate value of all cash and securities (so taken at their market value) so pledged and held.

3. The aggregate value of the securities (taken at their then market value to be determined by the Trustee . . . .) pledged hereunder and then held by the Trustee issued by (1) governments, states, municipalities, and other governmental authorities, or (2) banks, trust companies, insurance and other financial institutions, or (3) railroad, land and marine transportation companies, or (4) public utility companies, or (5) industrial companies, or (6) companies or organizations engaged in any and all other kinds of enterprises or business, at no time shall exceed 33 1/3% of the aggregate value of all cash and securities (so taken at their then market value) so pledged and held.

4. The term "securities" . . . . shall be deemed to include only stocks, bonds, notes and other securities admitted to the list of the New York Stock Exchange. The term "cash" . . . . shall be deemed to include cash, certificates of deposit and bankers' acceptances maturing not more than ninety days after their date.

5. From time to time prior to authenticating and delivering the bonds, the Trustee shall determine the market value of the securities held by it under the terms of this Agreement.

6. The Trustee . . . shall determine the market value of the securities pledged hereunder and then held by the Trustee at a time convenient to it during each of the months of January, April, July and October in each year. . . . The Trustee shall certify in writing to the Company within ten days after the close of each of the months above indicated, (1) the aggregate market value of such securities so determined, (2) the amount of all cash held by the Trustee hereunder and (3) the total principal amount of all Bonds then issued and outstanding hereunder.

The Financial Investing Company reported, on October 15, 1925, a holding of 127 different securities in its portfolio, of which 113 were bonds, 6 preferred stocks and 8 common stocks. Approximately 50% of the Company's investments are in foreign securities.

**The Morristown Securities Corporation.**—This investment trust organized under New York State laws in the latter part of December, 1924, has made no public appeal for funds; although by the end of August, 1925, 13,560 shares of \$100 par value 5% cumulative preferred stock (of a total of 25,000 authorized) and 48,120 shares of no-par value common stock (of the 75,000 common shares authorized) had been paid in. The present subscription price is on the basis of:

100 shares 5% cumulative preferred stock at \$100	\$10,000
200 shares common stock at \$12.50 . . . . .	2,500
Total for block . . . . .	\$12,500

The charter of the corporation is exceedingly broad, permitting it to undertake, in addition to all phases of the ordinary investment trust business (including underwriting), financial reorganizations, industrial pursuits and the creation and negotiation of acceptances. Standards of investment are left to the directors and are not specified in the charter or by-laws.

**The American Bond and Share Corporation.**—An interesting, though rather complicated, set-up is provided by this

company, which offers to the investing public securities of the following type:

Common stock in shares of \$10 par value. This has been mainly subscribed by the Bridgeport, Connecticut, firm creating the company, and by a few private investors.

Preferred stock paying 7% and carrying a par value of \$25. This stock cannot be issued "unless the cash paid for it, added to the cash and liquid securities put there by sales of common stock, amounts to at least one-third more than the par value of all the preferred stock issued." To introduce a mild form of participation, it is provided that the preferred shall share equally with common, after 7% has been paid on the latter, until 8% has been distributed to both. Common stock purchase warrants are also attached.

Bonds are offered, bearing 6% interest. They are secured by specific pledge of negotiable securities and are convertible into preferred and common stock, on the basis of their respective parities, in the ratio of three-fourths of the face value of the bonds for the former, and one-fourth for the latter.

In other words, in financing the company there may be raised \$5000 in bonds for every \$1000 in preferred stock, and \$333 in common shares for every \$1000 in preferred.

In investing the funds of the company, it is provided that at least 60% must be in bonds and bankstocks, not more than 25% in preferred stocks, and not more than 15% in dividend paying common shares. Otherwise wide discretion rests in the management. This company (sometimes referred to as the "Merritt Plan") has not yet had time to demonstrate the practicability of its interesting and apparently liberal provisions for the different types of investors furnishing its funds.

**Other Types of Investment Trust.**—In this chapter, in which an attempt has been made to outline the organization and operating methods of the majority of American investment trusts, a broad distinction has been observed between those

issuing participating certificates, of one form or another, in a jointly managed investment fund, and those offering their own shares with the rights and claims in a going business which ordinarily belong to common stock. This brief résumé has suggested other possible bases of classification. These might be the degree of diversification in the portfolio,—whether confined to common stocks alone, to bonds and other obligations, or including both junior and senior securities; whether narrowed to investment in financial institutions only, or broadened to embrace all lines of business; or the relationship of share or certificate holders to the control of the issuing trust—whether they possess merely beneficiary rights, as in the case of certificate owners and of shareholders in certain common law trusts, or are granted full voting power in the periodic appointment of the board of directors; or the policy in borrowing—whether shares alone are issued—merely common, or common and preferred, or whether bond and other indebtedness is also incurred. No careful student of American experimentation with this most interesting of financial agencies can doubt that out of the variety of forms now being tested with all that originality which is characteristic of any adaptation in the United States of methods employed in other countries, there will emerge several types of investment trust of demonstrated usefulness, which will become an integral part of our financial system. In the meantime it is well to bear in mind that although the undertakings described seem in the main to conform to the definitions given earlier of the investment trust, several are obviously of too recent origin for accurate predictions as to their future.

The old adage that “There is nothing new under the sun” would appear also to be exemplified in the evolution of American investment trusts. The writer has at hand, for instance, the prospectus of the “New York Stock Trust” (April 1, 1889) “organized by a Trust Agreement executed by the within named Trustees and the American Loan and Trust Company of the City of New York.” The offering is 50,000 shares at \$10.

The New York Stock Trust proposes to secure safety . . . . by becoming interested in a large number of separate individual securities . . . . a host of . . . . first-class stocks and bonds representing properties and industries the country over, so that the Trust will have for its security the whole business of the country. . . . The Trust obtains its income, firstly from the dividends which these various securities pay, and secondly, from the fluctuations in price of each separate security, which are utilized so that these also pay a profit.

It is stated in the Memorandum of Trust Agreement that :

It shall be the duty of the trustees, if at any time the risk or liability, in any single security which has hitherto been bought or sold as aforesaid, shall amount to one-tenth of the total amount of the certificates then outstanding, then and in that event, the trustees shall take from the Capital Fund, or from the accumulated profits, or from the reserve fund, such a sum as in their judgment seems best, and apply such sum for the purpose of lessening and bringing down the risk or liability in that security to a schedule percentage or to no percentage, but in no case shall the risk or liability in any single security be allowed to exceed one-tenth the amount of the certificates for the time being.

The semi-annual produce of the Capital Fund and of the securities arising from any source whatsoever, shall be applied in manner following :

First: in payment of all expenses during the preceding six months ; second, in payment of a dividend, if earned, at the rate of six per cent per annum on the amount of the certificates, to the holders thereof, upon the first Tuesday in the months of April and October of each and every year ; third, in payment of a royalty as hereinafter provided, to Roderick H. Smith, the inventor of the aforesaid plan of operating ; fourth, in payment of an extra cash dividend as hereinafter provided ; fifth, in establishing a reserve fund as hereinafter provided.

Certificate holders are entitled to voting privileges. The prospectus concludes :

These trusts (referring to certain British investment trusts previously mentioned) while proposing, according to their circulars, to do most of their business in this country, are organized under an English law. . . . The New York Stock Trust is the first American Investment Trust ever organized, and acknowledges itself subject to American law and the will of the American people.

There is in all this a strangely familiar ring.



## CHAPTER XVII

### OUTLOOK FOR INVESTMENT TRUSTS IN THE UNITED STATES

**Emergence of the Small Investor.**—Enough has been said in preceding chapters to indicate the interest now existing in one or another application of investment trust principles in the United States. The question suggests itself whether the investment trust in the strict sense of the term is likely to take permanent root in America, and, if so, along what lines it may be expected to evolve. Only by outlining the principal circumstances which account for this widespread present interest is it possible to visualize the possibilities of the investment trust on this side of the Atlantic.

One of the most important of these circumstances is the emergence of the small investor as the dominating factor in American finance. Before the war the majority of issues were sold primarily to a comparatively small group of well-to-do investors. Now scarcely any issue of importance is floated without an appeal to the rank and file and investment bankers as never before are building up elaborate distributive organizations. The ownership of our gigantic corporations is more and more widely distributed. The person of modest means came into his own during the nation-wide Liberty Loan drives, and the salutary habit of clipping coupons has continued with the American people. Although men of wealth also find it to their advantage to acquire investment trust securities, these are par excellence the means by which the "little fellow" may enter the investment field on something approaching terms of equality with the rich.

**Complexity of Corporate Finance.**—Another factor of consequence is the increasing complexity of corporate finance,

and, especially, the difficulty experienced by the average investor, whose cooperation is essential these days, in analyzing the factors affecting safety and yield in the confusing array of securities offered him.

Furthermore, it must not be forgotten that the interplay of "professional" and economic forces on stock exchanges, render it ever more difficult for any but the shrewd, well-informed, and exceptionally powerful to speculate without probability of drastic losses. The investment trust, being all of these, is in position, if well managed, to realize profits in the "ups" and "downs" of the market, by buying during "bear" movements, selling during "bull" movements, and doing both at the same time in different bourses and different countries as these find themselves, during any given period, in varying phases of the speculative or credit cycle.

**A World Creditor Position.**—Another circumstance which will undoubtedly give impetus to the development of investment trusts in America is the assumption since 1916 of a world creditor position by the United States, and the increasing dependence of foreign governments, commerce, and industry upon the rank and file of American investors at a time when currency and exchange, tariffs and commercial conditions in old and new countries alike are perhaps more confusing to the average American than ever before. There do not exist today, and probably never will exist again, the wide margins of yield (from 2 to 4%) which once obtained in England between domestic and foreign investments of nearly comparable safety. Nevertheless there are currently found such differences in rates of return between otherwise similar American and foreign securities as may be conservatively and profitably capitalized by investment trusts placing part of their capital abroad.

Attention has been directed in Chapter VI to the differences in yield between comparable foreign securities at current prices in London and New York, and in considering the yield which

American investment trusts may expect from their capital, it is important to bear in mind the comparative undervaluation which many foreign issues, adequately secured and payable as to principal and interest in dollars, even yet experience in the American markets. It is not likely that this differential in favor of the American investor can continue indefinitely, for the change from a national debtor to a creditor position, the abundance of American capital available for overseas employment, the growing importance of our export trade, and the increasing familiarity with foreign issues, must in time completely absorb it.

The following is quoted from the *Guaranty Survey* of September 29, 1924:

Foreign bonds, although they possess varying degrees of investment merit, are as a class selling at prices substantially below their intrinsic values. Obligations of sound governments are generally recognized as the standard of investment worth, yet we have the anomaly of good foreign government bonds selling to yield as much as four per cent more than United States Government obligations. This discrepancy is due not so much to a positive distrust of the credit of foreign governments as to a lack of understanding as to what should form the basis of sound governmental credit. The tendency to judge risk largely in terms of distance is certainly not based on sound reasoning and is gradually disappearing.

Again, from the same issue:

. . . . That the British put more faith in foreign securities than do the American people, and give to them ratings more closely approaching those given to home securities, is evidenced by a comparison of yields on foreign and domestic bonds on the New York and London Stock Exchanges. With the exception of a few of the very best railroads, the difference in the yield between domestic corporation bonds and foreign bonds in the London market is less than in the New York market.

Notwithstanding what may be termed a lingering American provincialism, it is of interest to observe that the volume of flotation of foreign issues, and the number of oversea securities

actively dealt in on the American stock exchanges are increasing at an astounding rate. In 1915, for instance, there were but eight foreign government, state, and municipal issues, exclusive of Canadian provincial and municipal issues, traded in on the New York Stock Exchange; in 1920 there were thirty-six; in 1924, there were ninety-five. When it is remembered that there are more Argentine securities alone listed and dealt in on the London Stock Exchange than there are bonds of all foreign countries listed on the New York Stock Exchange, it is easy to realize that a tremendous further expansion is required in American purchase of foreign bonds and shares before our investors are taking anything approaching their just proportion of overseas industrials and public utilities.

**Emphasis upon Common Share Investments.**—Any summary of circumstances encouraging the development of investment trusts in the United States must take account of the prevailing conviction among many economists and investors that in the long run a well-selected group of common shares constitutes a wiser investment than exclusively prior lien securities. In Chapter XVI some attention has been paid to a few American investment trusts which purchase exclusively or primarily common shares. There is no doubt that the investment trust may prove a most useful agency for effecting that distribution of risk and alertness of management which particularly commend themselves in handling common shares. Through these means some of the advantages of wise purchasing and holding of junior securities may accrue to the investor whose moderate funds would not otherwise permit investment in common shares without a risk of capital disproportionate to the probable added return.

It is of interest to recall, however, that British investment trusts keep the greater part of their investments in bonds and preferred stocks. The following table illustrates this fact in a few representative companies :

Name of Trust	Approximate Total of Portfolio	Approximate Proportion of Portfolio in Common Stock
Industrial & General Trust, Ltd. ....	£6,000,000	42%
The Investment Trust Corporation, Ltd. ....	5,668,000	17%
British Investment Trust, Ltd. ....	5,500,000	30%
Scottish Western Investment Company, Ltd. ....	2,430,000	16%
Anglo-American Debenture Corporation, Ltd. ....	1,830,000	22%
London and Provincial Trust, Ltd. ....	275,000	28%

The preponderance of prior lien securities among the holdings of investment trusts is by no means confined to Great Britain. In Chapter VI and elsewhere it has been shown that efficient management should realize profits on turnover without the necessity of specializing in common share investments. It is indeed a mistake to assume that investment trusts, either in England or America, will generally specialize in common shares, or that their profits from changing investments must depend largely upon their holdings of junior securities.

**Investment Problems of Endowed Institutions.**—Finally, in summarizing the circumstances which seem likely, now and in the future, to encourage the development of American investment trusts, sight must not be lost of the needs of educational endowments and philanthropic organizations. Investment problems of endowed institutions in the United States are only now beginning to receive the attention their importance warrants. There is here quoted practically in full an illuminating statement concerning financial policies of endowed colleges and universities recently submitted to the author by H. B. Allin-Smith of the University of Chicago. This quotation suggests the importance of well-conducted investment trusts, organized for the purpose of effecting expert investment and reinvestment of the funds of endowed institutions:

So great are the income needs of many growing educational institutions, so wealthy are they already in financial resources, and so promising their prospects of wider development in the next few decades, that a sound or "scientific" basis of financial management is



as imperative to their full educational success, as it is to any venture in the commercial sphere.

It is no wonder then that the administrative boards of endowed colleges and universities begin these days to question carefully the suitability of their investments, the adequacy of income received from them, and the financial problems raised by expanding and many-sided requirements of curriculum, research, plant and equipment.

A relatively new attitude toward investment policies is appearing out of this closer financial scrutiny. A business-like plan is being evolved to replace an "academic" policy (or lack of it) in educational finance management. Some schools are even entering into consultation with investment houses for investment analysis and advice. It is not in any sense their desire to reap the rewards of speculation. Rather, a timely conviction has developed that today's broader investment opportunities and clearer public insight into financial market operations should be adapted to the pressing requirement of greater educational income. No longer is it enough to say that philanthropy shall provide required endowment from time to time; now the acknowledged obligation of prominent educators seems to be to develop an efficient management of funds once given, and thereby to justify the further confidence of philanthropists in contributions toward meeting needs of advancing education.

A study of changing opinion on this subject shows an interesting gradual evolution of this newer view of investment policy as applied to endowment funds. It began in the closing years of the past century, but with little marked change until the first decade of the twentieth century. Educators, and administrators of the funds on which institutions of higher learning operated, then made, and some perhaps do still make, a definite distinction between the more secure and the more speculative forms of investment. On the one hand were the suitable, including only real estate, mortgages, and bonds. In contrast, on the other hand, were the unsuitable, encompassing almost every other form of income-bearing investment, and designating especially the stocks of commercial corporations. The difference between those two broad groups was that one offered security by means of a tangible, eventually realizable, asset based on property, while the other group meant nothing more than a partnership in the vicissitudes of business.

A number of occasional opinions from persons of authority in the educational world of those days reveal a firm conviction against the intangible security of stocks in all the period before the Great War.

One writer prominent in this field,<sup>1</sup> recorded in 1900 the observation that then only few of 400 colleges with combined endowment funds of 150 million dollars had any part of their resources in stocks, that some held largely real estate investments, that four-fifths of all was secured by bonds or mortgages. He asserted the inference that the endowments were, therefore, invested well both as to security and as to income.

The generally accepted and emphasized belief at that period was that educational funds, being public trusts, were of a nature which precluded any right to run financial risks, and thus that any stock was unsuitable.

But that attitude was apparent at a time when the corporate form of organization, if it was not in its infancy, was at any rate in the stages of early childhood so far as size of organization, reputation for earning power, and capable management were apparent.

From 1905 to 1910, a more liberal view of stocks, preferred stocks at first and later common stocks, began to appear. There can be no doubt that this wider perspective in the matter of suitable securities coincided with the more convincing stability of large-scale corporations which subsequently have had their major development, in numbers and in scope.

During and since the period of the war, however, the present attitude has taken definite shape. It may be expressed in the terms used by a writer connected with a large investment organization,<sup>2</sup> in a 1916 treatise on "Sound Investing" to the effect that as the success of educational organizations depends on their yearly income which in turn varies with the extent of investments and the care given to managing them, and as the administrators of these institutions do not have strict accountability to outside controls, their investment policies are less hampered than in the case of trustee estates. In the absence of any specific restrictions they can, therefore, shift investments to accord with altering business conditions and with the influence those conditions have on stocks and bonds.

Thus, by degrees measured in years, the scale of investments laid down for endowments of educational institutions widened until now it begins to include all accepted marketable forms of securities, if well and carefully chosen.

That post-war years have seen the direct focusing of attention on a scientific management of educational fund investments comes about naturally then. It is corollary to the effects of the war. Costs of

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<sup>1</sup> Charles F. Thwing, President of Western Reserve University.

<sup>2</sup> Paul Clay, Moody's Investors' Service.

living are recognized as being permanently raised to a higher level by the economic forces arising out of war time. A dollar income on invested endowment, measured in terms of the buildings, supplies, or services it will buy for a college or university, goes only one-half or two-thirds as far as it did in years immediately prior to 1914. Consequently more dollars are needed to maintain a college, or any other enterprise, at its *status quo ante bellum*, and even many more dollars to maintain a normal rate of progress and expansion in the face of growing educational demands.

Two means of added income are apparent. One is the acquisition of more endowment. This many colleges of high standing have recently undertaken, or are undertaking. The second means is the securing of greater income from endowment invested, and this applies to all future endowment fund conditions. This second proposition is what is so clearly altering the view of college administrators in formulating their financial policies.

Undoubtedly the several circumstances dealt with in the foregoing quotation are creating conditions favorable to the organization of investment trusts. The further question now presents itself as to forms which it may be expected investment trusts will assume in the United States.

**Types of Investment Trust Offerings.**—In Chapter XVI several American trusts have been described which issue only participating certificates or beneficiary shares in a jointly constituted investment fund. In the same chapter attention has been directed to other trusts which either exercise their borrowing power or contemplate doing so, thus offering to the public their obligations as well as their shares. Undoubtedly both types will develop among us. The former will be primarily a means of enabling individuals to invest and reinvest co-operatively in diversified common shares. The latter will be a means of offering to the investors the several types of securities which are familiar to them in terms of ordinary corporate bonds and stocks, but which, when issued by investment trusts, should carry special assurances of safety and yield.

**Investment Trust Obligations.**—However far may be carried the criticisms of bonds or non-participating preferred shares as long-term investments, it is inevitable that certain classes of investors should always prefer them to common stocks. Investment trust bonds which are protected by amply diversified and carefully selected investments, and further fortified through adequate margins contributed by shareholders, are among the most desirable and safe securities anywhere obtainable. If experience in Great Britain is any guide, investment trust bonds of this character will be welcomed by American trustees, financial officers of philanthropic and educational endowments, savings banks, insurance companies and discriminating investors generally, especially when "Blue Sky" and other regulatory laws are so amended as to take cognizance of what is as yet in the United States a comparatively unfamiliar institution. The same, of course, applies to preferred stock issued by investment trusts.

From the standpoint of the common shareholder the issuance of debenture bonds or non-participating preferred shares, if carefully restricted, may also be regarded as advantageous in certain respects. Assuming, for instance, that on the average 7% may be earned on invested capital by an American trust, that 3% in addition may be realized in profits on turnover, that current administrative expenses will average annually from  $\frac{1}{2}$  to 1% of the invested funds, and that the cost of raising capital through the sale of common shares will be 5%, it will be seen that net earnings should be equivalent to approximately  $8\frac{1}{2}$ % on the amount so subscribed by the public (disregarding for the moment organization expenses). Investment trusts, however, may be expected to borrow on at least a 6% basis in the United States at present, and the cost of raising capital through the issuance of bonds should not bring their entire borrowing charges to a point exceeding  $6\frac{1}{4}$ % on the funds so obtained. A simple calculation will show that after bonds have been issued to an amount equalling the capital contributed by



shareholders, after the return (10%) on investment and turnover suggested above has been obtained on the entire capital, and after the above mentioned administrative charges have been borne, the net earnings available for common shareholders would be approximately 11% on their investment.

The fact that all or a considerable part of the profits realized in changing investments should be reinvested rather than distributed in dividends, and that reserves should be accumulated from net earnings, would argue the advisability of a smaller dividend than  $8\frac{1}{2}$  or 11% respectively in the foregoing illustrations. Income so reinvested, however, enhances the equity behind the common stock and ultimately increases its dividend paying power.

**Shorter Term Borrowing.**—Investment trusts organized in the United States should be able to borrow from financial institutions as well as investors. Among the former may be included banks, and commercial paper houses, as well as business organizations, and individuals, which desire from time to time to make safe and profitable short-term use of loanable funds. The forms which such borrowing might take range from advances on promissory notes, or loans on security collateral, to certificates of from six months to two years maturity. When bonds cannot be profitably marketed, when interest rates are too high on debts of long maturity, or when an imminent change in the bond market augurs wisdom in delay, short-term loans may be contracted on terms profitable for investment trusts.

Short-term borrowing, however, should be undertaken with extreme caution, and should not as a rule be more than a fraction of the bonded indebtedness. The volume of borrowing is ultimately dependent upon the amount of invested capital derived from sale of common or preferred stock, and the dictates of wisdom, if not the exigencies of the market, would probably limit the total of borrowing under all forms to an amount from one to two times the former.



It is far more likely in the case of bond borrowing than in the negotiation of short-term loans that time will operate to the advantage of American investment trusts. As this type of organization becomes better known, the bonds will perhaps be placed on a strictly gilt-edged basis, and will be much in demand on the part of those seeking the highest measure of safety obtainable beyond the palings of government obligations. The underwriting and brokerage commissions should tend to fall, and it is not improbable that all classes of investment trust financing will seek the lower cost levels which give the British trusts such a tremendous advantage. Just as bank acceptances, practically unknown in American domestic commerce in pre-war years, are now winning their way to a recognized position among sound short-term investments, so investment trust bonds should gain public favor by their essential soundness. New York, Massachusetts, and many other states have passed laws permitting trustees, savings banks, and other institutions under their supervision to invest a proportion of their funds in bankers acceptances, and the same may be expected for bonds of investment trusts in course of time.

**Investment Trust Preferred Stock.**—The same general line of reasoning which commends the issuance of bonds might also be applied to preferred stock. When conservatively restricted, as illustrated in Chapter III and elsewhere in this volume, preferred stock of investment trusts makes an excellent investment, offering a yield somewhat higher than the bonds, and a security only second to theirs. The advantage to the common shareholder of issuing preferred stock may readily be figured as in the illustrations above. Again assuming, for instance, that investment return and gains realized on turnover average 10% on the invested capital, that costs of marketing the trust's securities are 5%, that interest is payable on bonds and dividends on preferred stock at 6 and 6½% respectively, and that administrative expenses are 1% of resources, it is clear that

the net earnings applicable to common stock dividends would equal approximately 15½% on capital so subscribed, provided the funds of the trust are derived from sale of common shares, preferred stock, and bonds, in the ratios of 25, 25 and 50% respectively.

Illustrations of this kind may be multiplied indefinitely. The capital structure of any trust—whether it issues only shares or certificates, or raises in part capital on one or more fixed-cost arrangements—must be determined with a view to the principal purpose in organizing the trust, and the conditions of the market at the time of organization. In any case, if the illustrative figures given in the above paragraphs are, as the author assumes, applicable to conditions in the United States at the present time, it would seem that investment trusts may anticipate a very fair return to their shareholders. This should be realized with as little delay as is necessarily involved in selecting good investments, and is not hypothecated upon the building up of a new or untried business, or the establishment of further markets for an old one.

**Underwriting.**—Participation in underwriting of sound issues, which has been shown in Chapter V to be an appreciable factor in the income of investment trusts in the United Kingdom, can only be counted upon when American trusts have attained considerable size, and formed natural groupings of sufficient investing power to absorb easily and safely any underwriting guaranty which must be taken up. This remains, therefore, a deferred, but none the less an important potential source of income.

**The Interests of Promoters.**—But what can be said, however, of the prospect of profits for organizers of investment trusts in the United States? A certain number of people there will doubtless be whose interests in creating investment trusts will be primarily to afford more profitable and secure investment channels to friends, clients, or employees. Savings banks,

trust companies, and perhaps even insurance companies, may be tempted to enter a field so closely akin to their own, and so readily explored by their existing administrative equipment, with primary concern for the welfare of investors rather than profits beyond their own moderate compensation. The development of investment trusts on a large scale is likely, however, to have its impulse mainly from those who anticipate added gains in the form of shares for services, purchases at less than market value, or other privileges reserved for them.

The device of "founders shares" is too well known to require special comment here, and the same is true of the numerous other ways in which a share in future profits is reserved for those whose initiative and ideas have been responsible for the creation of a successful enterprise. In general, however, it must be remembered that investment trusts are not "get rich quick" schemes, that any arrangements of the kind should be made fully known to those who are entitled to the facts, and that of all types of business, the investment trusts can least afford to countenance any practices tending to undermine public confidence in officers and directors, and will most profit in the sedulous fostering of high ideals and faithful service in the administration of funds entrusted to them. Such devices as are used to assure to founders and promoters an added participation in profits should be adopted only after a realistic estimate of probable earnings, and with every protection to assure, after all prior charges have been met, a liberal dividend to common shareholders.

In fact, it is doubtful whether organizers of investment trusts should as a rule seek means of compensation other than the just reward for their marketing efforts, the stated outlay for administrative overhead, the opportunity of acquiring common stock at offering prices to the dealers, or perhaps clearly defined subscription rights in future issues. At least, until investment trusts have demonstrated their earning power beyond any question, it would be inadvisable to saddle new under-

takings with claims to profits which have not been acquired for cash. The same precautions which, in the organization of national banks, prevent the issuance of stock for services, commend themselves for similar reasons in the promotion of investment trusts.

**Impartiality in Choosing Investments.**—It is also important to avoid the impression that an investment trust is created largely for the purpose of absorbing certain blocks of questionable or untried securities. The management of the trust should take an entirely unprejudiced view in building up its investments, and for this reason close connections with issuing houses or brokers should be avoided, unless definite assurance exists that conscious or unconscious bias will not lead to the use of the investment trust as a convenient “unloading” device, or a “patient beast of burden for pet issues.” Moreover, the trust should always expect to pay no more than the commonly accepted brokerage fees for the purchase and sale of its holdings.

It is hardly to be expected, in fact, that a properly conducted investment trust will be in position to net its founders a return until some time after it has attained a satisfactory dividend paying position. If the investment trust is to maintain its own executive officers or an independent managerial organization is to be created, a capital of \$5,000,000 or more would probably be required before a self-sustaining basis is reached.

**Centralization of Management.**—The need of constant alertness and undivided attention in managing to best advantage an investment trust portfolio, and the many peculiar angles of the business, render advisable the creation of such specialized administrative organizations. Once a competent statistical staff has been created and the ordinary executive tasks have been systematized, the organization of new investment trusts may easily be undertaken by the managerial office already functioning, which would be in favorable position to serve as manager



or fiscal agent of such companies. Independently operating investment trust development and administration companies of this kind should ultimately prove profitable to their founders and shareholders, and of considerable advantage to investment trusts in undertaking managerial or other services at the decreasing costs made possible by specialization in the business and by the savings of large-scale organization.

**Financing Investment Trusts.**—Much may be said for the development in the United States of a type of investment trust midway between the financing and the purely investing kind, that is, a company whose funds must be invested in sound marketable securities to a specified minimum percentage thereof, but whose resources above this amount may represent diversified financing. In this way urgently needed capital might be supplied for foreign and domestic enterprises of promise, the initial needs of which are at once too large for local bankers to supply and too small for commanding the interest of reputable issuing houses. The temptation is, however, for financing investment trusts to depart very far from the road traversed by the investment trust proper. Once the active promotion of subsidiary enterprises is undertaken, the tendency is natural for the financing company to offer other supplementary financial services and gradually to be drawn into the whole range of kindred activities. Moreover, it requires skilful management to maintain anything like a real diversification of risk for all except financing companies of very large capital, for an initial commitment encourages further participation, and large additional advances may appear imperative in critical times to save the investment already made.

**The Prospect.**—Whether, however, the American investment trust follows exclusively the road of conservative investment, or seeks to some extent to enter the domain of active promoting and financing, there can be no doubt that it will prove an important instrumentality in making more potent the



influence of the small investor in the financial world. It will encourage thrift, and promote caution in the choice of investments. It will introduce further stabilizing elements into business and speed the placing of capital in fundamentally sound enterprises. It will broaden the financial horizon of the American investor and familiarize him with opportunities in foreign countries. And in so doing it will constitute one more important factor in facilitating our exports and in strengthening the bases of our material prosperity.



## APPENDIX



# APPENDIX A

## SECTION I

### PRINCIPAL BRITISH INVESTMENT TRUST COMPANIES CLASSIFIED ACCORDING TO THEIR MAIN GROUPINGS

Not all of the companies listed here are, strictly speaking, investment trusts. A few companies doing in part a financing or mortgage business are included in order to keep the groups intact. This exception applies at most to ten or a dozen companies scattered throughout the groups. Those starred are companies whose earnings are analyzed in Chapter X.

#### I. THE COMPANIES IN WHICH ROBERT FLEMING & COMPANY HAVE DIRECT INTEREST

- \*Alliance Trust Co., Ltd.
- \*British Investment Trust, Ltd.
- \*Caledonian Trust Co., Ltd.
  - First Scottish American Trust Co., Ltd.
  - Second Scottish American Trust Co., Ltd.
  - Third Scottish American Trust Co., Ltd.
  - Clydesdale Investment Co., Ltd.
- \*Investment Trust Corporation, Ltd.
- \*Metropolitan Trust Co., Ltd.
  - Northern American Trust Co., Ltd.
  - Scottish Western Investment Co., Ltd.
  - Sterling Trust, Ltd.
- \*United States & General Trust Corporation, Ltd.

#### II. THE MERCANTILE AND ANGLO GROUP

- \*Anglo-American Debenture Corporation, Ltd.
- \*The Guardian Investment Trust Co., Ltd.
  - Second Guardian Trust Limited
- \*The Imperial Colonial Finance & Agency Corporation, Ltd.
- \*Mercantile Investment & General Trust Co., Ltd.
  - Second Mercantile Trust, Limited
- \*United States & South American Investment Trust Co., Ltd.
  - Railway Share Trust and Agency Co., Ltd.
- \*Railway Debenture & General Trust Co., Ltd.



## III. THE THROGMORTON AVENUE GROUP

- \*The Alliance Investment Co., Ltd.
- \*The American Investment & General Trust Company, Limited
- \*The Foreign, American & General Investments Trust Co., Ltd.
- \*The Foreign & Colonial Investment Trust Company, Ltd.

## IV. THE LORD ST. DAVID'S GROUP

- \*The Consolidated Trust, Ltd.
- The Equitable Debenture & Assets Corporation, Ltd.
- The Eastern Mortgage & Agency Co. (1902) Ltd.
- \*The Government & General Investment Co. Ltd.
- \*The Governments Stock and other Securities Investment Co. Ltd.
- The International Financial Society, Ltd.
- \*The Municipal Trust Co., Ltd.
- New York & General Trust Ltd.
- \*The Omnium Investment Co., Ltd.
- \*The Premier Investment Co., Ltd.
- \*The Union Commercial Investment Co., Ltd.
- Also affiliated with this group {
  - The Aberdeen Trust Company, Ltd.
  - East of Scotland Trust, Ltd.
  - British Electric Traction Co.

V. THE EDINBURGH GROUP<sup>1</sup>

- \*The American Trust Co., Ltd.
- The British Assets Trust, Ltd.
- The British & Foreign Trust, Ltd.
- Edinburgh, Dundee & Aberdeen Investment Company, Ltd.
- \*The Edinburgh Investment Trust, Ltd.
- The Second Edinburgh Investment Trust, Ltd.
- \*The Third Edinburgh Investment Trust, Ltd.
- The Investors' Mortgage Security Company, Ltd.
- The Second Investors' Mortgage Security Company, Ltd.
- The Realisation & Debenture Corporation of Scotland, Ltd.
- The Scottish Investment Trust Co. Ltd.
- \*The Second Scottish Investment Trust Co. Ltd.
- Scottish American Investment Co., Ltd.
- The Scottish & Canadian General Investment Co., Ltd.
- Scottish American Mortgage Co., Ltd.
- Scottish Mortgage and Trust Co., Ltd.
- United States Investment Corporation, Ltd.
- Scottish National Trust Co. Ltd.

## VI. MISCELLANEOUS COMPANIES

(1) *Robert Benson & Co. Group*

- \*The Charter Trust & Agency, Ltd.
- \*The Merchants Trust, Ltd.

<sup>1</sup> This list is not inclusive of all Edinburgh investment trusts. Several are given above.

- (2) *Sir George Touche & W. S. Poole Group*  
\*The Industrial & General Trust, Ltd.  
\*The Second Industrial Trust, Ltd.  
\*The Trust Union Ltd.  
The Trustees Corporation, Ltd.  
and affiliated therewith  
The Debenture Corporation, Ltd.
- (3) *Paull & Williamson Group*  
The Scottish Northern Investment Trust, Ltd.  
The Second Scottish Northern Investment Trust, Ltd.
- (4) *Sir John R. Ellerman Group*  
\*Brewery & Commercial Investment Trust Ltd.  
\*Debenture Securities Investment Company, Ltd.  
London General Investment Trust, Ltd.
- (5) *Sir Henry Seymour King Group*  
\*Indian & General Investment Trust, Ltd.  
\*International Investment Trust, Ltd.
- (6) *Nathaniel Spens Group*  
The City Property Investment Trust Corporation, Ltd.  
\*Railway Investment Co., Ltd.  
Stock Conversion & Investment Trust, Ltd.
- (7) *James Anderson Group*  
\*River Plate & General Investment Trust Co., Ltd.  
River Plate Trust, Loan & Agency Company, Ltd.
- (8) *Davenport Group*  
\*General Investors & Trustees, Ltd.  
Cardinal Investment Trust, Ltd.
- (9) *Miscellaneous Companies*  
Beaver Trust, Ltd.  
British Steamship Investment Trust, Ltd.  
Canadian & Foreign Investment Trust, Limited  
Egyptian & Foreign Trust, Ltd.  
\*General & Commercial Investment Trust, Ltd.  
Glasgow American Trust Co., Ltd.  
\*London & South American Investment Trust, Ltd.  
\*London & Colonial Investment Corporation, Ltd.  
\*London Scottish American Trust, Ltd.  
\*London Trust Co., Ltd.  
Rio Claro Railway & Investment Co., Ltd.  
Traction & Power Securities Co., Ltd.  
United Discount & Securities Co., Ltd.  
\*United States Debenture Corporations, Ltd.

## SECTION II

APPROXIMATE OUTSTANDING CAPITAL, DEBENTURE AND SHARE,  
OF THE PRINCIPAL BRITISH INVESTMENT TRUSTS

Figures are for the companies of Section I. Some fifteen of the latter do not enter the 1912 figures.

	1912 £	1921 £
Ordinary Stock and Shares.....	21,000,000	32,000,000
Preferred Stock and Shares.....	26,000,000	34,000,000
Debentures and Debenture Stock.....	28,000,000	34,000,000
Total Outstanding Capital.....	75,000,000	100,000,000
Average Ordinary Stock.....	346,000	415,000
Average Preferred Stock.....	411,000	441,000
Average Debentures.....	443,000	444,000
Average Total Outstanding Capital.....	1,200,000	1,300,000

## SECTION III

A FEW BRITISH INVESTMENT TRUSTS CONCENTRATING  
THEIR INTERESTS IN CERTAIN AREAS OR INDUSTRIES

For source of more detailed list, see concluding note to Section V.

## RUBBER AND TEA

Anglo Straits Rubber and General Trust, Ltd.  
 British North Borneo Rubber Trust, Ltd.  
 Eastern International  
 Equatorial Rubber Trust, Ltd.  
 Hevea Rubber Trust, Ltd.  
 Operators' Trust, Ltd.  
 Rubber Plantations Investment Trust, Ltd.  
 Scottish Tea and Rubber Trust Co., Ltd.  
 Tea Share Trust

## RAILS, ELECTRIC POWER AND TRAMWAY COMPANIES

Central Bahia Railway Trust  
 Northern American Trust Co., Ltd.  
 Railway Investment Co., Ltd.  
 Rhodesia Railways Trust, Ltd.  
 South American Assets Co., Ltd.  
 Traction and Power Securities Co. Ltd.  
 British Electric Traction Co. Ltd.

## MINES

Barrier and General Trust, Ltd.  
Mining and General Trust of Canada, Ltd.  
Mining Investment Company of Glasgow, Ltd.  
Johannesburg Consolidated Investment  
Central Mining and Finance

## OIL

Oil Development Trust, Ltd.  
Oil Trust, Ltd.

By far the larger number of such companies are to be found in the "Financial, Land, and Investment" section of the Stock Exchange Intelligence.

## SECTION IV

A FEW INVESTMENT TRUSTS ORGANIZED FOR THE PURPOSE  
OF EFFECTING FINANCIAL REARRANGEMENTS

(Detailed information from sources cited below)

Callenders Share and Investment Trust, Ltd.  
Lake View Investment Trust  
New York & General Trust  
Mexican Central Railway Securities Company  
Rio Claro Railway & Investment Co.  
Sterling Trust  
Stock Conversion and Investment Trust

## SECTION V

A FEW TYPICAL BRITISH TRUST COMPANIES DOING IN  
PART OR WHOLE A FINANCING BUSINESS

British Canadian Trust, Ltd.  
British Foreign & Colonial Corporation  
Anglo-Scottish Trust  
Atlantic Trust  
British & General Debenture Trust  
British Empire Trust Co.  
British Maritime Trust, Ltd.  
Eastern International Rubber and Produce Co.

In 1920 the Articles were altered so as to enable proceeds from sale of investments to be apportioned between capital and revenue instead of crediting the whole sum to investment reserve account. The business is, there-

fore, divided into two distinct parts: (1) investment and trust; (2) general.

Law Debenture Corporation  
 London Maritime Investment Company  
 North of England Trustee Debenture & Assets Corporation,  
 Ltd.  
 Electric and General Investments  
 Orient Trust, Ltd.  
 South African & General Investment & Trust Co., Ltd.  
 South American Assets Co., Ltd.

For further companies, see lists in Stock Exchange Official Intelligence, either under "Financial Trusts," or "Financial, Land, and Investment Companies." From the same source, details concerning date of organization and outstanding capital can be obtained.

Most of the above companies are new and have not yet issued debentures. There are in all from 100 to 150 active companies of the kind which are not strictly investment trusts.

## SECTION VI

### CERTAIN AMERICAN INVESTMENT TRUSTS, INCLUDING SEVERAL WITH SPECIALIZED HOLDINGS, WITH DATES OF THEIR ORGANIZATION

*(Interested houses designated in several cases)*

The Alexander Fund, 1907  
 The First Investment Company of New Hampshire, 1916  
 International Securities Trust of America, 1921  
     American Founders Trust—Fiscal Agent  
 The Eastern Bankers Corporation, 1922  
 The Bond Investment Trust, 1923  
 The Investment Managers Company, 1924  
     (Roosevelt & Son)  
     (Wood, Low & Company)  
 The Massachusetts Investors Trust, 1924  
 The Morristown Securities Corporation, 1924  
     (Coggeshall & Hicks)  
 Wisconsin Investment Company, 1924  
 Joint Stock Securities Company, 1925  
     (Guy Huston & Company, Inc.)  
 The Financial Investing Company, 1925  
 The Bankstocks Corporation, 1925  
 New England Investment Trust, 1925  
 Securities Trading & Holding Corporation, 1925



Alwyn Corporation, 1925  
Bondshare Corporation, 1925  
American Bond & Share Corporation, 1925  
Financial and Industrial Securities Corporation, 1926  
    (Manufacturers Trust Co.)  
    (Redmond & Company)  
Joint Stock Bond & Share Company, 1926  
    (C. G. Taylor and Company)

## SECTION VII

CERTAIN AMERICAN FINANCING COMPANIES HAVING FOREIGN  
INTERESTS, AND OPERATING AS "FINANCING INVEST-  
MENT TRUSTS" IN WHOLE OR IN PART

*(Certain interested houses designated in several cases)*

(See Chapter XIII.)

Electric Investors, Inc.  
American International Corporation, 1915  
Overseas Securities Corporation  
Foreign Bond & Share Corporation, 1919  
    (Asia Banking Corporation)  
    (Mercantile Bank of the Americas)  
Foreign Finance Corporation  
    (J. P. Morgan & Company)  
American & Foreign Power Co., Inc., 1923  
    (Electric Bond & Share Company)  
International Power Securities Corporation, 1923  
    (Aldred & Company)  
American & Continental Corporation, 1924  
    (Dillon, Read & Company)  
North American Utility Securities Corporation, 1924  
United States & Foreign Securities Corporation, 1924  
    (Dillon, Read & Company)  
American-Belgian Financial Corporation, 1925  
    (Lee, Higginson & Company)  
    (White Weld & Company)  
American-European Utilities Corporation, 1925  
Swedish American Investment Corporation, 1925  
    (Lee, Higginson & Company)  
European Shares, Inc., 1926  
    (Hayden Stone & Company)  
German Credit & Investment Corporation, 1926  
    (Dillon, Read & Company)

## APPENDIX B

### CHRONOLOGICAL TABLE OF ORGANIZATION OF LEADING BRITISH INVESTMENT TRUSTS

(Those starred represent registration of an older trust incorporated by deed poll, of which the Submarine Cables Trust is now the only example.)

Year of  
Registration

- 1863 International Financial Society, Limited
- 1871 \*Governments Stock and Other Securities Investment Co., Ltd.  
Submarine Cables Trust
- 1873 Railway Debenture and General Trust Co., Ltd.  
Globe Telegraph & Trust Company, Ltd.  
The Scottish American Investment Co., Ltd.
- 1874 The Scottish American Mortgage Co., Ltd.
- 1879 \*American Investment & General Trust Co., Ltd.  
First Scottish American Trust Co., Ltd.  
\*Foreign & Colonial Investment Trust Co., Ltd.  
\*Municipal Trust Co., Ltd.  
Second Scottish American Trust Co., Ltd.  
Third Scottish American Trust Co., Ltd.
- 1881 Railway Investment Co., Ltd.  
River Plate Trust, Loan & Agency Co., Ltd.  
Sterling Trust, Ltd.
- 1883 Foreign, American & General Investments Trust Company, Limited
- 1884 Mercantile Investment & General Trust Co. Ltd.
- 1886 United States & South American Investment Trust Co., Ltd.
- 1887 Army & Navy Investment Trust Co., Ltd.  
British Steamship Investment Trust, Ltd.  
Omnium Investment Company, Ltd.  
Scottish Investment Trust Co., Ltd.  
Trustees Corporation, Ltd.

Year of  
Registration

- 1888 Alliance Trust Company, Ltd.  
Bankers' Investment Trust, Ltd.  
General & Commercial Investment Trust, Ltd.  
Guardian Investment Trust Company, Ltd.  
Government & General Investment Co., Ltd.  
International Investment Trust, Ltd.  
Investment Trust Corporation, Ltd.  
Railway Share Trust & Agency Co., Ltd.  
Realisation & Debenture Corporation of Scotland, Ltd.  
River Plate & General Investment Trust Co., Ltd.
- 1889 Alliance Investment Company, Limited  
British Investment Trust, Ltd.  
Consolidated Trust, Ltd.  
Edinburgh Investment Trust, Ltd.  
Gas, Water & General Investment Trust, Ltd.  
Indian & General Investment Trust, Ltd.  
Industrial and General Trust, Ltd.  
Law Debenture Corporation, Limited  
London & New York Investment Corporation, Ltd.  
London General Investment Trust, Ltd.  
London Scottish American Trust, Ltd.  
London Trust Company, Ltd.  
Merchants Trust, Ltd.  
Second Scottish Investment Trust Co., Ltd.  
United States Debenture Corporation, Ltd.
- 1890 Anglo-American Debenture Corporation, Ltd.  
Brewery and Commercial Investment Trust, Ltd.  
City Property Investment Co.  
Imperial Colonial Finance and Agency Corporation, Ltd.  
United States and General Trust Corporation, Ltd.  
United States Investment Corporation, Ltd.
- 1891 Investors' Mortgage Security Company, Ltd.
- 1892 Premier Investment Company, Ltd.
- 1893 New Investment Co., Ltd.
- 1895 Debenture Securities Investment Co., Ltd.
- 1896 British Electric Traction Co., Ltd.
- 1898 British Assets Trust, Ltd.
- 1899 Metropolitan Trust Company, Ltd.
- 1902 American Trust Company, Ltd.  
Second Edinburgh Investment Trust, Ltd.

Year of  
Registration }

- 1905 Egyptian & Foreign Trust, Ltd.  
Trust Union, Ltd.
- 1906 Equitable Trust of London, Ltd.
- 1907 Charter Trust & Agency, Ltd.  
General Investors & Trustees, Ltd.  
Scottish Western Investment Co., Ltd.
- 1908 Scottish Northern Investment Trust, Limited
- 1909 Canadian & Foreign Investment Trust, Ltd.  
The Witan Investment Co., Ltd.  
London Scottish Investment Trust, Ltd.
- 1910 British & Foreign General Securities & Investment Trust, Ltd.  
Caledonian Trust Co., Ltd.  
London & Colonial Investment Corporation, Ltd.  
Scottish & Canadian General Investment Co., Ltd.  
Second Scottish Northern Investment Trust, Ltd.
- 1911 Aberdeen Trust Co., Ltd.  
Second Industrial Trust, Ltd.  
Third Edinburgh Investment Trust, Ltd.
- 1912 Rio Claro Railway and Investment Co., Ltd.  
Electrical & Industrial Investment Co., Ltd.  
\*Rock Investment Co., Ltd.
- 1913 Clydesdale Investment Company, Ltd.  
London & South American Investment Trust, Ltd.
- 1914 Glasgow American Trust Co., Ltd.  
Union Commercial Investment Co., Ltd.
- 1920 Lake View Investment Trust, Ltd.
- 1921 Staveley Trust, Ltd.
- 1922 Redeemable Securities Investment Trust, Ltd.
- 1923 Second Mercantile Trust, Ltd.
- 1924 Scottish National Trust Co., Ltd.  
Second Guardian Trust Limited  
Independent Investment Co., Ltd.  
The Scottish Central Investment Trust  
Scottish United Investors Limited  
Scottish Eastern Investment Trust Limited
- 1925 Anglo Celtic  
Second Scottish National Trust Co., Ltd.  
Stockholders Investment Trust Ltd.  
St. Andrew Trust, Ltd.
- 1926 Third Scottish Western Investment Co., Ltd.

## APPENDIX C

### A COMPLETE DECLARATION OF TRUST OF A MASSACHUSETTS TRUST, OPERATING PURELY AS AN INVESTMENT TRUST

(See Chapter II)

#### INTERNATIONAL SECURITIES TRUST OF AMERICA

##### AMENDED DECLARATION OF TRUST

An AMENDED DECLARATION OF TRUST made at Boston, Massachusetts, this 25th day of May, 1923.

WHEREAS, . . . . (hereinafter called the Trustees), have been duly and regularly nominated, appointed and elected trustees under a certain declaration of trust made by . . . . dated April 18, 1921, as amended September 7, 1921, and are now all of the trustees acting under and by virtue of said Declaration of Trust; and

WHEREAS, the Trustees propose to receive monies from various persons who have agreed to subscribe for or purchase shares or interests in an enterprise for dealing in and with certain securities; and

WHEREAS, all said monies paid to and received by the Trustees together with any other funds and property hereafter acquired by them is to be held, used, invested, reinvested and managed, upon and subject to the trusts herein declared;

NOW, THEREFORE, the Trustees hereby declare that they will hold said monies so agreed to be paid to them and all other funds and property which hereafter may be acquired by them as such Trustees, together with the proceeds thereof, *in trust* to manage, invest, reinvest and dispose of same for the benefit of the holders from time to time of the certificates of shares issued and to be issued hereunder in the manner and subject to the stipulations herein contained.

#### ARTICLE I

1. The Trustees in their collective capacity shall be designated so far as convenient and practicable, as "International Securities Trust of America," and under that name, so far as convenient and practicable, shall conduct all their business and execute all instruments in writing.

2. From and after May 25, 1923, there shall be not less than three nor more than seventeen Trustees hereunder. The Trustees shall not be required



to be shareholders. At the annual meeting of the shareholders to be held in the year 1924, the shareholders entitled to vote shall elect not less than three nor more than seventeen Trustees who shall be divided into three classes, each class to contain as nearly as may be the same number of Trustees as each of the other classes. One class of such Trustees shall hold office for the term of one year next ensuing, one class for the term of two years next ensuing and one class for the term of three years next ensuing. Thereafter the shareholders entitled to vote shall elect not less than one Trustee nor more than six Trustees at each annual meeting of the shareholders, each Trustee to serve for the term of three years next ensuing. Each Trustee shall serve for the period for which he shall have been elected and until his successor shall have been elected and shall have accepted this trust. Each vacancy in the number of Trustees elected by the shareholders, whether occasioned by death, resignation, inability to act or any other reason shall be filled for the unexpired term as follows:

(a) In case the number of Trustees then acting shall be three or more, the Trustees may elect a successor Trustee to fill each or any such vacancy;

(b) In case the number of Trustees then acting shall be less than three, the Trustee or Trustees shall elect a successor Trustees to fill each such vacancy necessary in order to bring the number of Trustees to three and the three Trustees may then elect a Successor Trustee or Trustees to fill each or any additional vacancy; and

(c) In case there shall be no Trustee hereunder then acting the shareholders entitled to vote shall elect a successor Trustee to fill each vacancy for the unexpired term at a special meeting of such shareholders, which may be called and notice of which may be given by any officer hereunder or by any shareholder entitled to vote with respect thereto.

Upon the filing with the Depositary of the Declaration of Trust named herein of (1) a copy of the record of such election, certified to by the Secretary or Assistant Secretary, and (2) a written acceptance of this trust executed by the Trustee so elected, the trust shall vest without further act or deed in the newly elected Trustee together with the Trustee or Trustees then holding office. It shall be the duty, however, of any retiring Trustee or the administrator or executor of any deceased Trustee, to make a formal transfer if the same is deemed necessary or advisable by the remaining Trustee or Trustees.

At each annual meeting of the shareholders, beginning in the year 1924, the shareholders entitled to vote shall elect a Secretary to serve for the term of one year and until his successor shall have been elected.

3. The Trustees shall hold the legal title to all funds and property at any time belonging to this trust and, subject only to the specific limitations herein contained, they shall have the absolute control, management and disposition thereof, and shall likewise have the absolute control and conduct of all business of the trust. The naming of any specific duties and powers herein shall not be construed as limiting the general powers conferred upon the Trustees.

4. The Trustees are authorized and empowered to establish, maintain, manage and carry on within or without the State of Massachusetts and in the United States of America or elsewhere, the business of buying, selling and otherwise dealing in bonds, debentures, stocks, shares, evidences of indebtedness and other securities (hereinafter collectively called securities), particularly those of governments, corporations, associations and trusts, whether originating in the United States of America or elsewhere; and in connection therewith, subject to the provisions hereinafter contained, to lend and to borrow money, to issue bonds, debentures, and other evidences of indebtedness of the trust and to mortgage, pledge, hypothecate or dedicate the assets of the trust or any part thereof as security therefor, and in general to do or cause to be done all such acts and things as may be necessary or proper in connection with or appertaining to the efficient and expeditious conduct of such business.

5. The Trustees shall hold in their own names as Trustees of International Securities Trust of America or in the name of International Securities Trust of America or otherwise all bonds, debentures, stocks, shares, evidences of indebtedness and other securities, which shall belong to the trust. They shall be authorized to exercise all rights and incidents of ownership thereof including the right to receive any and all monies or other property payable with respect thereto, and to vote thereon as they in their discretion may deem advisable.

6. The Trustees shall pay all proper taxes or assessments of whatever nature, foreign, national, state or municipal, upon the property and income of the trust or any portion thereof and shall pay all proper expenses and charges incurred in the business of the trust. The Trustees are empowered to receipt for all sums of money at any time received by the trust, to employ counsel, to prosecute, defend and settle any suits or actions whether at law, in equity or otherwise, concerning or affecting the trust or the business thereof and to compromise or refer to arbitration any claims in favor of or against the trust.

7. The Trustees, subject to the provisions hereof, are authorized and empowered to secure, by agreement or otherwise, the services of agents, underwriters, contractors or others in connection with the disposition of shares and Bonds, notes or other evidences of indebtedness issued and to be issued hereunder and to pay therefor such salaries, commissions or other compensation as they may deem reasonable and proper.

8. The Trustees from time to time shall determine whether and to what extent, and at what times and places, and under what conditions and regulations the accounts and books of the Trustees, or any of them, shall be open to the inspection of the shareholders, and no shareholder or other persons shall have the right to inspect any account or book or document except as so determined.

9. The Trustees may adopt and use a common seal and a majority of all of the Trustees may adopt and may amend from time to time By-Laws regulating the conduct of their business.

10. The Trustees shall adopt Rules and Regulations, not inconsistent herewith, prescribing and fixing certain standards which must be met by each

security before such security shall be eligible for acquisition by the trust, and in addition, if the Trustees so desire, specifying rules of procedure, requirements and methods for the conduct of the business and affairs of the trust. The Rules and Regulations so adopted shall be binding upon the Trustees and their successors in the trust. No securities which shall not have met such standards of eligibility shall be acquired by or on behalf of the trust. The Rules and Regulations may be added to, altered or amended from time to time by two-thirds or more of the Trustees, provided only that said standards of eligibility as originally adopted by the Trustees shall never be lowered during the continuation of this trust. The Rules and Regulations shall be available only to the Trustees and their successors in the trust, and no shareholder, creditor or other person whosoever shall be entitled to inspect the same for any cause or reason whatsoever.

11. Regular and special meetings of the Trustees shall be held in such places, within or without the State of Massachusetts, and at such times and shall be called and notices thereof shall be given as shall be provided in the By-Laws. A majority of the Trustees shall be present at any meeting to constitute a quorum for the transaction of business. Except as herein otherwise expressly provided, any action taken by a majority of the Trustees present at any such meeting and any action assented to in writing by a majority of all of the Trustees without a meeting shall have the same validity and effect as if voted and consented to by all of the Trustees.

12. The Trustees shall elect annually from among their number, a President and from among their number or otherwise, a Treasurer. The Trustees may appoint from time to time one or more Vice-Presidents, Assistant Treasurers, Assistant Secretaries, and such other officers and agents as they may deem advisable, each to hold office for such period as the Trustees may determine. The powers and duties of such officers or agents shall be defined in the By-Laws, or by the Trustees. Action taken or authorized to be taken by any such officer or agent, in the proper exercise of powers so defined, shall have the same force and effect as if taken or authorized to be taken by the Trustees. The Trustees shall fix the compensation, if any, of the Secretary and of all the officers and agents elected or appointed by them. The President or Treasurer may be removed by the affirmative vote of a majority of all of the Trustees with or without a meeting, and any other officer or agent appointed by the Trustees by like action or by vote of the Trustees at any meeting at which a quorum is present. Any officer or agent may resign by giving written notice of his intention so to do to the Trustees. In case of the resignation, removal, refusal or inability to act of any officer, including the Secretary, or of any agent, the Trustees may appoint a successor to fill the vacancy of the unexpired term. The Trustees shall appoint a Secretary to act until the annual meeting of the shareholders to be held in the year 1924.

13. A majority of all of the Trustees, in their discretion, subject to the provisions in the By-Laws may appoint from among their number, an Executive Committee or any other committee to which they may delegate such powers as they may think proper.

14. The Trustees are hereby authorized to pay to themselves a sum not to exceed \$20 as compensation for actually attending any regular or special meeting of the Trustees and, in addition thereto, to pay to themselves such compensation for their own services as they may deem reasonable; provided that the aggregate compensation so paid to all of the Trustees shall not exceed, in any one year, a sum equal to one and one-half per cent ( $1\frac{1}{2}\%$ ) of the net profits of the trust (as hereinafter defined) during that year. Each Trustee shall be reimbursed for all expenses and indemnified against all liabilities paid out and incurred by him in connection with the discharge of his duties as Trustee. Any Trustee may be employed by the Trustees to perform any special, legal, financial or other services and may be elected or appointed to any office, and shall in any such case be entitled to receive such additional compensation as the Trustees may fix and determine.

15. Any Trustee may acquire, hold, and sell shares in the trust in his individual name or on his personal account, or jointly with other persons, or as a member of any firm, without being thereby disqualified as a Trustee, and while owning and holding any shares on his personal account, shall be entitled to the same rights and privileges with respect thereto as any other shareholder.

16. Any Trustee, or any firm of which he may be a member, or any corporation of which he may be a stockholder, director or officer, may contract with the Trustees as fully and to the same effect as though he were not a Trustee. No Trustee so interested shall vote with respect to any such contract.

17. So far as strangers to the trust are concerned, a resolution adopted by the Trustees or a writing signed by a majority of all of the Trustees, certified as such by the Secretary or Assistant Secretary, shall be conclusive evidence that any action taken or authorized to be taken thereby is within the powers of the Trustees.

## ARTICLE II

1. Meetings of the shareholders shall be held in the City of Boston in the Commonwealth of Massachusetts or in such other place or places of said Commonwealth as shall be specified in the respective notices or waivers of notices thereof.

2. Annual meetings of the shareholders shall be held on the fourth Monday in March of each year beginning with the year 1924, at such place, date and hour as the Trustees may designate. Special meetings may be called by the President or by any two of the Trustees.

3. Notice of each meeting of the shareholders, whether annual or special, shall be given by the Secretary, by mailing a written or printed notice of the meeting to each shareholder entitled to vote at such meeting, at his registered address, at least twelve (12) days before the day on which the meeting is to be held. Notice of any meeting of the shareholders need not be given to any shareholder who shall attend such meeting in person or by proxy, nor to any shareholder who, in person or by attorney thereunto authorized, shall waive such notice in writing or by telegraph. Notice of any adjourned meeting of the shareholders need not be given.



Every notice of a meeting of the shareholders, besides stating the time and place of the meeting, shall state briefly the objects thereof. Any business whatsoever may be transacted at any meeting of the shareholders at which all of the shareholders entitled to vote in respect thereto are present in person or represented by proxy.

4. Except as otherwise in ARTICLE III hereof provided, each shareholder shall be entitled to one vote for each share standing in his name on the books of the Trustees. Any shareholder may vote either in person or by proxy.

5. At any meeting of the shareholders, the presence in person or representation by proxy of the holders for the time being of a majority in number of the shares then issued and outstanding and entitled to vote shall be necessary and sufficient to constitute a quorum for the transaction of business; provided that any number of such shareholders present in person or represented by proxy at any annual election of Trustees and the secretary though holding less than a majority in number of the shares then issued and outstanding and entitled to vote, may elect Trustees and a secretary. In the absence of a quorum the shareholders present in person or represented by proxy at the time and place for which such meeting shall have been called or to which it shall have been adjourned, or if no shareholder is present in person or represented by proxy, any officer may adjourn such meeting for a period not to exceed twenty days. At any such adjourned meeting at which a quorum may be present any business may be transacted which might have been transacted at the meeting as originally called. At all meetings of the shareholders, a quorum being present, all matters, except as herein otherwise specifically provided, shall be decided by the vote of the holders of a majority in number of the shares present in person or represented by proxy and entitled to vote.

### ARTICLE III

1. The beneficial interest in this trust shall be divided into Two Hundred Fifty Thousand (250,000) Preferred Shares of the par value of One Hundred dollars (\$100) each and Eight Hundred Thousand (800,000) Common Shares without nominal or par value.

2. The Preferred Shares shall be issued in series of not less than One Thousand (1,000) shares each. From time to time as they shall deem desirable, the Trustees shall authorize the issuance of one or more such series of Preferred Shares and shall prescribe for each such series (a) a distinctive letter or figure or both, (b) the rate of dividends (not exceeding eight per cent. (8%) per annum on the par value thereof), which the holders thereof shall be entitled to receive and (c) the premium which the holders thereof shall be entitled to receive upon redemption, which shall not be more than fifteen per cent. (15%) of the par value thereof.

3. The preferences and rights of and the limitations and restrictions upon the Preferred Shares of each and every series, issued and to be issued, are as follows:



(a) The holders of Preferred Shares shall be entitled to receive quarterly, on the first days of March, June, September and December in each year, beginning with September 1, 1923, dividends at the rate of, but not exceeding, the rate prescribed by the Trustees for each series, respectively, before any dividends on the Common Shares shall be paid or set apart for payment. Dividends on the Preferred Shares shall be cumulative, so that if in any year dividends thereon at said rate on each series, respectively, shall not have been paid, the deficiency shall be payable before any dividend shall be paid or set apart for payment on the Common Shares. Whenever cumulative dividends upon the Preferred Shares shall have been paid in full and the instalment for the current quarterly dividend period shall have been declared and paid or a sum sufficient for the payment thereof shall have been set apart, and the requirements hereinafter set forth in subdivision (c) of this paragraph 3, shall have been met or provided for, the Trustees may declare and pay dividends on the Common Shares. The Trustees shall never declare or pay dividends on any Preferred Shares of one series without at the same time declaring and paying dividends on all Preferred Shares of every series then issued and outstanding in proportion to the dividend rate prescribed by the Trustees for each such series of Preferred Shares.

(b) In the event of any liquidation, dissolution or winding up (whether voluntary or involuntary) of this trust, before any amount shall be paid to or any assets distributed among the holders of the Common Shares, the holders of the Preferred Shares shall be entitled to receive, either in cash or in property or both, in the discretion of the Trustees, an amount equivalent in value to the par value of each such share, and an amount which, together with the aggregate of the dividends theretofore paid thereon, will equal that per cent. per annum on the par value of each share from June 1, 1923 (or in case of shares issued subsequent to June 1, 1923, from the date of issuance thereof), to the date of such liquidation, dissolution or winding up, as shall have been prescribed by the Trustees as the rate per annum of dividends payable with respect to each series of Preferred Shares, respectively. After such payment in full to the holders of the Preferred Shares, the holders of the Common Shares shall be entitled to receive the remaining assets and funds of the trust in proportion to the number of shares held by them, respectively. In case, on any such liquidation, dissolution or winding up, the assets and funds of the trust shall be insufficient to make such payment in full to the holders of the Preferred Shares, the holders of Preferred Shares of each series shall be entitled to share equally in such payment until they shall have received the par value of their shares, and thereafter to share in proportion to the dividend rate prescribed by the Trustees for each such series of Preferred Shares until they shall have received such payment in full.

(c) When all cumulative dividends then payable as herein provided upon the Preferred Shares shall have been paid, the Trustees, on the first

day of September, 1923, and on each Preferred share dividend payment date thereafter when required as hereinafter provided, shall set aside on the books of the trust an amount equal to twelve and one-half per cent ( $12\frac{1}{2}\%$ ) of the net earnings of the trust (as hereinafter defined) for the three months period then ended, after having first deducted from such net earnings all dividends paid or set aside for payment on the Preferred Shares and all funds and securities set aside or reserved for the benefit of bondholders in conformity with paragraph 5 of ARTICLE V hereof during such period. Such amounts shall be so set aside by the Trustees only until the aggregate thereof shall be sufficient to pay cumulative dividends as herein provided for a period of not less than ten (10) years upon all Preferred Shares then outstanding, and thereafter only the proportion of such amounts, if any, necessary in order that the total fund so established shall be sufficient so to pay such cumulative dividends for a period of not less than ten (10) years upon all Preferred Shares at the time outstanding.

The net earnings of the trust for all purposes whatsoever under this Amended Declaration of Trust shall be calculated for any period by deducting from the net operating income of the trust for such period (1) all taxes, (2) all interest on obligations of the trust and (3) depreciation.

(d) So long as dividends at the rate per annum prescribed by the Trustees for each series of Preferred Shares, respectively, shall be paid thereon as herein provided, the holders of the Preferred Shares shall not be entitled to vote for the election of Trustees nor, except as otherwise herein specifically provided, shall any voting power whatever on any question be vested in the holders of the Preferred Shares; but in the event that dividends on the Preferred Shares at said rate per annum shall not be paid during any calendar year and such default shall not have been made good during the next ensuing calendar year, then and in such event the holders of the Preferred Shares, until such default shall have been cured, but no longer, shall have and may exercise full voting rights upon such shares held by them to the same extent as if the foregoing limitations upon said rights had not been established. The holders of Preferred Shares, however, may vote upon any question submitted to the shareholders, provided that they shall have been requested so to do by the Trustees.

(e) All, but (except as herein in sub-division (f) of this paragraph 3 provided) not less than all, of the Preferred Shares at any time outstanding shall be subject to redemption at the option of the Trustees at the price for each share of One Hundred Dollars (\$100.) plus the redemption premium prescribed by the Trustees for each series of Preferred Shares, respectively, and an amount which, together with the aggregate of the dividends theretofore paid thereon, will equal that per cent. per annum on the par value of each share from June 1, 1923 (or in case of shares issued subsequent to June 1, 1923, from the date of issuance thereof), to the date of such redemption, as shall have been prescribed by the

Trustees as the rate per annum of dividends payable with respect to each series of Preferred Shares, respectively. Such price is hereinafter referred to as the redemption price of the Preferred Shares. Such redemption shall be effected and notice thereof given as the Trustees may determine.

(f) Whenever cumulative dividends upon the Preferred Shares for all prior years shall have been paid and a sum sufficient for the payment of the current quarterly dividend shall have been set apart and dividends at the rate of not less than Five Dollars (\$5.) per share shall have been paid on the Common Shares during the next preceding twelve months, and the requirements hereinabove set forth in sub-division (c) of this paragraph 3, shall have been met or provided for, but not otherwise, the Trustees in their discretion may retire any or all of the Preferred Shares of any or all series then outstanding. Such retirement shall be effected, in the discretion of the Trustees, either (1) through the purchase of such shares of any series at the lowest price obtainable, in no event exceeding the redemption price of the shares so purchased or (2) through redemption of such shares. If less than all the shares of any one series are to be retired, the shares so to be redeemed shall be selected by the Trustees by lot among all of the Preferred Shares of any or all series then outstanding. The Trustees having determined the shares so to be redeemed shall give written notice at least ten (10) days before the date of payment specified in such notice to each holder of such shares at his registered address, and from and after the date of payment specified in such notice (unless default shall be made in redemption thereof) all rights of the holders of such shares to participate in the earnings, in the assets or otherwise in the trust shall cease, and the rights of the holders of such shares shall be limited thereafter to the receipt of the redemption price thereof. All Preferred Shares so redeemed shall be cancelled and retired.

(g) The Trustees, from time to time, but only in conformity with the foregoing provisions of this ARTICLE III, may declare and pay dividends on the Preferred and Common Shares, but the declaration, amount and payment of each such dividend shall be wholly within the discretion of the Trustees. The Trustees may declare and pay dividends on the Preferred Shares out of the reserve set aside in accordance with sub-division (e) of this paragraph 3, only in case there shall then be no other net earnings or surplus of the trust available for such purpose; but in no event shall a dividend on the Common Shares be declared or paid out of such reserves.

(h) No amendment to or alteration of this Declaration of Trust which shall authorize the issuance of additional Preferred Shares of any class having preferences prior to or concurrent with the preferences of the Preferred Shares herein authorized or which shall effect any change in the preferences or rights of the holders of the Preferred Shares herein authorized, shall be effective unless consented to by the holders of at least two-thirds in number of the Preferred Shares and two-thirds in number

of the Common Shares then outstanding. The consent of such shareholders shall be evidenced either (1) by an instrument or instruments in writing filed with the Trustees or (2) by a vote of the shareholders given at a meeting thereof.

4. The Trustees may issue, sell and dispose of the Preferred Shares herein authorized, or any of them, at such times and to such persons as they shall deem advisable; provided that the Trustees shall receive in consideration therefor at least the par value of such shares. The Trustees may issue, sell and dispose of the Common Shares herein authorized, or any of them, in such manner, by way of stock dividend or otherwise, for such consideration, at such times and to such persons as they shall deem advisable.

5. The certificates of ownership of the Preferred Shares and Common Shares shall be, respectively, in substantially the form of the form of certificates annexed hereto and marked "Exhibit A" and "Exhibit B." Such certificates shall be executed on behalf of the trust by the President or a Vice-President and by the Secretary or an Assistant Secretary or the Treasurer or an Assistant Treasurer, or by such other officers or representatives of the trust as the Trustees may from time to time designate. The Trustees may make such rules and regulations as they may deem expedient concerning the issuance, transfer and registration of certificates representing shares and may appoint transfer agents or registrars of transfers, or both and may require such certificates representing shares to bear the signature of either of them or both.

6. Shares shall evidence only the rights specifically set forth in this instrument. The death of a shareholder or Trustee during the continuance of this trust shall not operate to determine the trust, nor shall it entitle the legal representatives of the deceased shareholder to an accounting, or to take any action in the courts or elsewhere against the Trustees, but the executors, administrators or assigns of any deceased shareholder shall succeed to the rights of such decedent under this trust. The ownership of shares hereunder shall not entitle the shareholder to any title in or to the trust property whatsoever, or right to call for partition or division thereof, or for an accounting. It is hereby expressly declared and agreed that a trust, and not a partnership, association or enterprise for the joint account of the shareholders, is created by this instrument, and the shareholders are *cestuis que trustent* and hold no other relation to the Trustees than those of *cestuis que trustent* with only such rights as are conferred upon them as such *cestuis que trustent* hereunder.

#### ARTICLE IV

1. The business of the trust shall be limited in nature to the investment and reinvestment of capital. The Trustees shall not use the funds of this trust in connection with nor engage the trust in any enterprise involving promotion, business management or underwriting.

2. Upon receipt by them, from time to time, of monies from any source



for the account of the trust, the Trustees as soon thereafter as they may deem practicable and desirable shall invest in marketable securities all of such funds then available for investment. No securities shall be purchased by or on behalf of the trust which shall not be eligible for acquisition by the trust under the terms of the Rules and Regulations which shall be adopted by the Trustees; and no securities shall be purchased unless:

(a) Reliable information shall be obtainable with respect to the history, management, assets, earnings and income of the governmental authority, corporation or organization issuing such securities;

(b) Unless the history of the nation or country in which such securities shall have originated shows financial stability and recognition of private property rights; and

(c) The governmental authority, corporation or organization issuing such securities shall have been established for a period of at least four (4) years.

The trust shall not purchase or otherwise acquire any of its Common Shares, nor shall it purchase or otherwise acquire any of its Preferred Shares or any of its bonds or other evidences of indebtedness except for the purpose of retirement and cancellation.

3. In selecting securities for purchase in accordance with the foregoing restrictions the Trustees shall exercise their own discretion and shall be entitled to rely upon information believed by them to be reliable, and in no event shall they be liable or responsible in any manner to anyone for so doing.

4. Of the total funds of the trust invested and available for investment by the Trustees, not more than seventy per cent. (70%) may be invested at any one time in securities originating in the United States of America, not more than fifty-five per cent. (55%) may be invested at any one time in securities originating in England, and not more than thirty-five per cent. (35%) may be invested at any one time in securities originating in any other nation or country. Not more than ten per cent. (10%) of the total funds which may be so invested in securities originating in any one country may be invested in securities representing any one distinct class of business or industry. So long as the total funds of the trust invested or available for investment shall be less than One Hundred Thousand Dollars (\$100,000), not more than five per cent. (5%) of the total funds which may be so invested in securities originating in any one country may be invested in any one such security; when such total available funds shall amount to One Hundred Thousand Dollars (\$100,000), but shall be less than One Million Dollars (\$1,000,000), not more than three per cent. (3%) of the total funds which may be so invested in securities originating in any one country may be invested in any one security; and when such total available funds shall amount to One Million Dollars (\$1,000,000) or over, not more than one and three-fourths per cent. (1¾%) of the total funds which may be so invested in securities originating in any one country may be invested in any one such security other than governmental securities. The trust shall never purchase or hold a majority in interest of any one issue of securities.



5. From time to time, the Trustees shall sell and dispose of all securities within one (1) year after they shall have ascertained that such securities would not then be eligible for purchase by them hereunder. The Trustees, in their discretion, at any time and from time to time, may sell and dispose of any securities belonging to the trust, and may invest and reinvest in accordance herewith the proceeds received therefrom.

6. From time to time, as soon after the acquisition thereof as may be practicable, the Trustees shall deposit for safekeeping with one or more banks, trust companies or other financial institutions to be selected by them, all securities held by the trust and not otherwise deposited or pledged as security for the payment of obligations of the trust. The Trustees, from time to time, may withdraw any or all of the securities so deposited for the purpose of selling or disposing thereof or for the purpose of depositing or pledging the same as security for the payment of obligations of the trust. The institutions which may be so selected as depositaries by the Trustees shall be fully protected in acting in accordance with the directions of the Trustees and shall in no event be liable for the proper application of the securities so withdrawn from deposit or the proceeds thereof.

7. The Trustees in their discretion may lend monies belonging to the trust, but only in case the repayment thereof shall have been secured by a valid pledge or other hypothecation of securities, at the time eligible for acquisition by the Trustees hereunder, or of bonds or other evidences of indebtedness which shall have been issued by the trust. No such loan shall be made in an amount exceeding eighty-five per cent. (85%) of the then market value of such securities or such bonds or other evidences of indebtedness so pledged or hypothecated. In order to realize upon collateral so pledged or hypothecated, the Trustees may bid in and purchase any such securities, bonds, or other evidences of indebtedness at a price not exceeding the amount loaned thereon together with unpaid interest, if any.

## ARTICLE V

1. The Trustees shall have and may exercise, subject only to the specific limitations in this ARTICLE V contained, full power and authority to create, issue, sell and dispose of bonds, debentures, notes and other evidences of indebtedness of the trust (hereinafter called the Obligations), to define all terms and conditions with respect thereto and to secure the payment of the principal of and interest on any of the Obligations with the assets, funds, and property of the trust, or any part thereof, to the same extent and with the same force and effect as if each and every act and thing done or suffered to be done by or under the direction of the Trustees in connection therewith had been authorized, approved and consented to by the holders at the time of all the Preferred and Common shares of the trust then issued and outstanding. The Trustees may create, authorize, issue, secure, sell and dispose of the Obligations, or any of them, at any time and from time to time, whenever they may deem it to be advisable. All monies received by the trust from the

sale of the Obligations shall be considered funds available for investment within the meaning of ARTICLE IV hereof.

2. The principal amount of all of the Obligations at any one time outstanding shall not exceed Forty Million Dollars (\$40,000,000). No Obligation shall be issued unless at the time of the issuance thereof the value of the cash and securities (taken at the net cost price thereof) held by the Trustees hereunder shall exceed the aggregate amount of all indebtedness of the Trustees hereunder (except that represented by the principal amount of the Obligations) by an amount equal at least to one hundred eighty per cent. (180%) of the aggregate principal amount of such Obligation and all other Obligations at the time issued and outstanding.

3. Each Obligation shall be a direct obligation of the trust and shall bind the trust, to the full extent of its assets, funds and property, to the repayment thereof in accordance with the tenor and purport of such Obligation. The holder of any such Obligation shall look only to the assets, funds and property of the trust for the payment thereof and neither the Trustees nor the shareholders shall be personally liable therefor in any manner whatsoever. No Obligation shall be issued which shall not contain on the face thereof a notation expressly stipulating that neither the Trustees nor the shareholders shall be held to any personal liability whatsoever under or by reason of such Obligation.

4. The Trustees may secure the payment of the principal of and interest on any or all of the Obligations from time to time outstanding by creating, or agreeing to create, a specific lien or charge, in favor of the holders thereof, upon all or any part of the assets, funds, securities and property of the trust and may provide for the adequate and expeditious enforcement of such lien or charge by or on behalf of such holders in the event of a default in the performance of any promise or covenant made or undertaken by the Trustees to or with such holders or any person or corporation on their behalf. The Trustees may transfer legal title to any or all cash and securities at any time and from time to time held by the trust, to any person or corporation but *in trust* only so to secure the Obligations or may themselves receive such cash and securities from the trust at any time and from time to time and may hold legal title thereto, apart from their duties as Trustees hereunder and as trustees of an express trust, *in trust* so to secure the Obligations. Neither the Trustees, nor any person or corporation, shall hold such cash and securities *in trust* except upon condition that the Trustees, acting hereunder, shall have and may exercise at all times, except during the continuance of an event of default with respect to the Obligations, the absolute right to withdraw therefrom any such cash or securities for any reason so long as any such withdrawal shall not reduce the value of the cash and securities remaining therewith at the time below the minimum value, if any, prescribed therefor by the Trustees.

5. The Trustees shall make no covenant or agreement in any way respecting the Obligations.

(1) Which may require the trust at any time or from time to time to set aside or reserve for any purpose cash or securities (taken at their

then market value) in an amount in excess of twenty per cent. (20%) of the prior net earnings of the trust;

(2) Which may require that the securities so held in trust shall have been purchased by the Trustees as hereinbefore in ARTICLE IV provided;

(3) Which may require that the minimum value of the cash and securities (taken at their then market value) so held in trust shall at any time be greater than one hundred fifteen per cent. (115%) of the principal amount of all of the Obligations secured thereby at the time issued and outstanding;

(4) Which may require the doing, or suffering to be done, of any act or thing which may be contrary, either expressly or by clear and necessary implication, to any of the terms of this Amended Declaration of Trust.

6. The provisions and limitations in this ARTICLE V expressed shall not be construed as limiting or defining the right and authority of the Trustees generally to borrow money and negotiate loans for the trust from banks, bankers or others in connection with which no public offering or subscription is intended.

#### ARTICLE VI

1. The Trustees shall have no power to bind the shareholders personally by any act, neglect or default and all shareholders, bondholders and all persons or corporations extending credit to, contracting with, or having any claim against the Trustees shall look only to the assets, funds and property of the trust for payment of such contract or claim or for any indemnity or for the payment of any debt, damage, judgment or decree or of any money that may otherwise become due or payable from the Trustees, so that neither the Trustees nor the shareholders shall be personally liable therefor.

2. In every bond, note, contract or other agreement for the payment of money borrowed it shall be the duty of the Trustees or other officers or agents of the trust expressly to stipulate that neither the Trustees nor the shareholders shall be held to any personal liability whatsoever under or by reason of such bond, note, contract or other agreement. The like expressed stipulation shall be embodied in other agreements whenever the Trustees in their discretion so determine.

3. The Trustees shall not be liable for errors of judgment in acquiring, holding or disposing of property or otherwise in conducting the business of the trust, or for any loss arising out of any investment, nor for any act or omission to act performed or omitted by them in the execution of this trust in good faith. Nor shall they be liable for the acts or omissions of each other nor of any officer, agent or servant appointed by or acting for them.

#### ARTICLE VII

1. This trust shall continue for the term of twenty-one (21) years after the death of the last survivor of . . . . at which time the then Trustees

shall proceed to wind up its affairs, liquidate its assets, and distribute the same as hereinbefore provided among the holders of shares hereunder according to their respective rights. For the purpose of winding up the affairs and of liquidating the assets of the trust, the then Trustees shall continue in office until such duties shall have been fully performed.

2. This Amended Declaration of Trust may be amended or altered (except as regards the liabilities of the Trustees and the shareholders, except as regards the provisions of paragraph 10 of ARTICLE I and of ARTICLE V hereof, and except as hereinbefore provided in sub-paragraph (h) of paragraph 3 of ARTICLE III) by the consent of the holders of at least two-thirds ( $\frac{2}{3}$ ) in number of the shares then issued and outstanding and entitled to vote. The consent of such shareholders shall be evidenced either by an instrument or instruments in writing filed with the Trustees, or by a vote of the shareholders given at a meeting thereof.

### ARTICLE VIII

1. This instrument is executed in five (5) original counterparts, each of which shall be deemed an original hereof. The acceptance of certificates of shares issued hereunder shall constitute the holders thereof parties to this agreement with the same force and effect as if they had signed their names and affixed their seals hereto.

2. This instrument is executed in the Commonwealth of Massachusetts and with respect to the laws thereof; and the rights of all parties and the construction and effect of each and every provision hereof shall be construed according to the laws of said state.

3. The original of this instrument shall be filed with International Trust Company, of Boston, Massachusetts, but the Trustees shall have power at any time to change or add to such depository.

In Witness Whereof, said Trustees . . . . hereinbefore mentioned have hereunto subscribed their names and affixed their seals in token of their acceptance of the trust hereinbefore mentioned, for themselves and their successors, the day and year first above written.

### EXHIBIT "A"

#### INTERNATIONAL SECURITIES TRUST OF AMERICA

#### Preferred Shares

Par Value \$100

No. . . . . Series . . . . . Shares

THIS CERTIFIES THAT . . . . .  
is the owner of . . . . . fully paid and non-  
assessable Preferred Shares Series . . . . . of INTERNATIONAL  
SECURITIES TRUST OF AMERICA (hereinafter called the Company), of the par  
value of \$100 each, transferable only on the books of the Company in person



or by attorney, upon surrender of this certificate properly endorsed. This certificate is issued subject to an Amended Declaration of Trust dated May 25, 1923 (a copy of which is on file with.....), to which reference is hereby made with the same effect as if herein set forth in full, and to all of the terms and conditions of which the owner of this certificate by accepting the same expressly assents. The Preferred and Common shares of the Company are entitled respectively to the preferences and are subject to the terms and conditions as to voting power and otherwise, and to the restrictions and qualifications fixed by said Amended Declaration of Trust, the clauses of which authorizing the issuance of shares so preferred and limited are printed on the reverse side hereof and by reference incorporated herein.

IN WITNESS WHEREOF the duly authorized officers of INTERNATIONAL SECURITIES TRUST OF AMERICA have hereunto subscribed their names and caused the seal of Company to be hereunto affixed this.....day of ..... 19.....

### EXHIBIT "B"

#### INTERNATIONAL SECURITIES TRUST OF AMERICA

##### Common Shares

##### No Par Value

No.....Shares

THIS CERTIFIES THAT.....is the owner of.....fully paid and non-assessable Common Shares of INTERNATIONAL SECURITIES TRUST OF AMERICA (hereinafter called the Company), without nominal or par value, transferable only on the books of the Company in person or by attorney, upon surrender of this certificate properly endorsed. This certificate is issued subject to an Amended Declaration of Trust dated May 25, 1923 (a copy of which is on file with.....), to which reference is hereby made with the same effect as if herein set forth in full, and to all of the terms and conditions of which the owner of this certificate by accepting the same expressly assents. The Preferred and Common shares of the Company are entitled respectively to the preferences and are subject to the terms and conditions as to voting power and otherwise, and to the restrictions and qualifications fixed by said Amended Declarations of Trust, the clauses of which authorizing the issuance of shares so preferred and limited are printed on the reverse side hereof and by reference incorporated herein.

IN WITNESS WHEREOF the duly authorized officers of INTERNATIONAL SECURITIES TRUST OF AMERICA have hereunto subscribed their names and caused the seal of the Company to be hereunto affixed this.....day of ..... 19.....



# APPENDIX D

## SECTION I

### BALANCE SHEET AND INCOME ACCOUNT OF THE INTERNATIONAL SECURITIES TRUST OF AMERICA

#### INTERNATIONAL SECURITIES TRUST OF AMERICA

#### BALANCE SHEET

November 30, 1925

#### ASSETS:

##### INVESTMENTS AT COST—STOCKS AND BONDS:]

Pledged with trustee for secured gold bonds.	\$2,948,801.21	
Less—Sold but not delivered.....	181,590.43	\$2,767,210.78
		<hr/>
* Unpledged.....		1,420,225.35
		<hr/>
		\$4,187,436.13

##### BOND INTEREST RESERVE FUND:

Securities pledged with trustee, at cost.....	\$	6,601.50	
Cash pledged with trustee.....		18,785.38	
		<hr/>	
			25,386.88

CASH PLEDGED WITH TRUSTEE FOR SECURED GOLD BONDS ..... 1,408,571.53

##### OTHER CASH DEPOSITS:

With fiscal agent.....	\$	202,316.31	
* With foreign banks.....		775,237.03	
With domestic banks to meet December 1, 1925, dividends and interest.....		152,428.45	
		<hr/>	
			1,129,981.79

ACCRUED INTEREST RECEIVABLE ..... 68,271.48

\* These assets are held by and in the name of the fiscal agent, the American Founders Trust, or their nominees.

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\$6,819,647.81

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## LIABILITIES:

## SHARE CAPITAL:

## Cumulative Preferred:

Authorized—250,000 shares, par \$100... \$25,000,000.00

## Issued and outstanding—

1,077 shares, Series A 7%.....	\$	107,700.00	
907 shares, Series B 6%.....		90,700.00	
20,266 shares, Series C 6½%.....		2,026,600.00	\$2,225,000.00

## Common:

Authorized—1,500,000 shares no par value

Issued—36,224 shares..... 1,150,387.43

\$3,375,387.43

## SECURED 6% SERIAL GOLD BONDS:

Series A—maturing June 1, 1928.....	\$	172,000.00
Series B—maturing June 1, 1933.....		2,243,500.00
Series C—maturing June 1, 1943.....		584,500.00

3,000,000.00

## CURRENT LIABILITIES:

Bond interest—payable December 1, 1925.....	\$	90,480.00
Preferred dividends—do.....		31,286.76
Common dividends—do.....		30,661.69
Owing to foreign banks.....		97,940.99
Federal income taxes.....		33,600.53

283,969.97

## SURPLUS:

## Appropriated:

Bond interest reserve.....	\$49,599.91	
Preferred dividend reserve.....	28,361.50	\$ 77,961.41

## Unappropriated:

Premium on preferred stock sold.....	\$ 1,892.50	
Undivided profits.....	80,436.50	82,329.00

160,290.41

\$6,819,647.81

[On November 30, 1925, the Fiscal Agent had earned options to purchase during a period of years a total of 75,019.9 1/3 common shares at \$11 1/9 per share, as reimbursement for services rendered and expenditures made by the Fiscal Agent in assuming management expenses, operating expenses (except only interest, taxes and Trustees' fees), and all sales cost of International Securities Trust of America. Under contract, the exercise of these options is restricted to the issuance of not more than 10% of the total common shares outstanding in each year to April 1, 1931; and not more than 12½% each year thereafter.]

INTERNATIONAL SECURITIES TRUST OF AMERICA  
INCOME ACCOUNT  
For the Year Ended  
November 30, 1925

<b>Income:</b>	
Interest and dividends .....	\$325,404.06
Profit on sales of securities .....	105,951.61
Gross income .....	<u>\$431,355.67</u>
<i>Deduct:</i>	
Bond interest .....	\$97,024.98
Taxes paid or accrued .....	41,035.31
Management expense including adjustments for prior periods .....	<u>15,053.76</u>
	153,114.05
Net income before appropriations .....	<u>\$278,241.62</u>
<i>Deduct:</i>	
Appropriated for bond interest reserve .....	\$41,787.24
Preferred dividends .....	<u>48,593.95</u>
	90,381.19
	\$187,860.43
<i>Deduct</i> —Appropriated for preferred dividend reserve .....	<u>22,868.24</u>
Balance transferred to undivided profits .....	<u>\$164,992.19</u>
<b>UNDIVIDED PROFITS</b>	
Balance at November 29, 1924 .....	\$ 7,207.90
<i>Add</i> —Profit for the year per above .....	<u>164,992.19</u>
	\$172,200.09
<i>Deduct</i> —Common dividends paid .....	<u>91,763.59</u>
Per balance sheet .....	<u>\$ 80,436.50</u>

INTERNATIONAL SECURITIES TRUST OF AMERICA  
CAPITAL OUTSTANDING AND ESTIMATED SURPLUS  
At March 1, 1926

<b>6% Secured Gold Bonds:</b>	
Series A June 1, 1928 .....	\$ 172,000.00
" B June 1, 1933 .....	3,980,000.00
" C June 1, 1943 .....	<u>848,000.00</u>
	\$ 5,000,000.00
<b>Preferred Shares:</b>	
Series A 7 % .....	\$ 107,700.00
" B 6 % .....	90,700.00
" C 6½ % .....	<u>3,226,600.00</u>
	3,425,000.00
Common Shares (43,725 Shares no par value) .....	<u>1,529,820.76</u>
Total Capital Paid In .....	\$ 9,954,820.76
<b>Surplus and Reserves:</b>	
Premium on Preferred Shares .....	\$ 8,892.50
Surplus and Reserves (Estimated) .....	<u>238,000.00</u>
	246,892.50
<b>Total</b> .....	<u>\$10,201,713.26</u>

## SECTION

REVENUE ACCOUNT AND BALANCE SHEET  
TRUST LTD., ONE OF THE STRONGEST OF

## THE INDUSTRIAL AND

*Dr.*

## REVENUE ACCOUNT FOR THE

	"A" ACCOUNT			"B" ACCOUNT			TOTAL		
	£	s.	d.	£	s.	d.	£	s.	d.
To Interest on Debenture Stock, less Income Tax.....	48,685	0	1	25,226	14	4	73,911	14	5
" Rent, Salaries, Office and General Expenses.....	17,448	4	11	—			17,448	4	11
" Directors' Fees.....	12,500	0	0	—			12,500	0	0
" Staff Pension Fund.....	766	11	9	163	12	10	930	4	7
" Legal Expenses.....	299	2	4	—			299	2	4
" Auditors' Fees.....	525	0	0	—			525	0	0
" Special Disbursements.....	566	16	4	15	15	0	582	11	4
" Fee to Trustees for Debenture Stockholders.....	350	0	0	—			350	0	0
" Dividend for the year on the 4½ per cent Cumulative Preference Stock, less Income Tax.....	38,362	10	0	5,231	5	0	43,593	15	0
	119,503	5	5						
Of which charged against "B" Account.....	3,474	0	10	3,474	0	10	—		
	116,029	4	7						
" Balance carried to Appropriation Account.....	—			212,565	19	11	212,565	19	11
	£116,029	4	7	£246,677	7	11	£362,706	12	6

£256,159 14s. 11d.

*Dr.*

## REVENUE APPROPRIATION

	£	s.	d.	£	s.	d.
To Amount reserved in respect of Taxation.....				2,000	0	0
" Amount applied to extinguish Debenture Stock Rebate and Expenses Account.....				49,485	0	0
" Transfer to "B" Reserve Fund.....				25,000	0	0
" Interim Dividend at 5 per cent (less Income Tax) on the Ordinary Stock for the half-year to 30th Sep- tember, 1924, paid 1st November, 1924.....				48,437	10	0
" Proposed Final Dividend at 9 per cent (less Income Tax) on the Ordinary Stock for the half-year to 31st March, 1925, making 14 per cent for the year.	87,187	10	0			
" Balance carried forward.....	37,563	5	3			
				124,750	15	3
				£249,673	5	3

## II

OF THE INDUSTRIAL AND GENERAL  
THE LONDON INVESTMENT TRUSTS

## GENERAL TRUST, LIMITED

YEAR TO 31ST MARCH, 1925

Cr.

	"A" ACCOUNT			"B" ACCOUNT			TOTAL		
	Income not			Income subjected					
	subjected to			to or exempt from					
	Corporation			Corporation					
	Profits			Profits					
	Tax at source			Tax at source					
	£	s.	d.	£	s.	d.	£	s.	d.
By Dividends, Interest and other Income received during the year, less Income Tax.....	115,873	5	1	246,677	7	11	362,550	13	0
" Transfer and other Fees.....	155	19	6	—			155	19	6

£116,029	4	7	£246,677	7	11	£362,706	12	6
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## ACCOUNT

Cr.

	£	s.	d.	£	s.	d.
By Revenue Account—						
Balance for the year to 31st March, 1925, before providing for the dividend on the 4½ per cent Cumulative Preference Stock .....	256,159	14	11			
Deduct—Dividend on the Preference Stock as shown above, less Income Tax.....	43,593	15	0			
				212,565	19	11
" Balance from last year.....				37,107	5	4

£249,673	5	3
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## THE INDUSTRIAL AND

Dr.

## BALANCE SHEET,

	£	s.	d
<b>To CAPITAL AUTHORIZED AND ISSUED:—</b>			
4½ per cent Cumulative Preference Stock.....	£1,250,000	0	0
Ordinary Stock.....	1,250,000	0	0
		2,500,000	0 0
<b>" Debenture Stock Issued—</b>			
3½ per cent Debenture Stock.....	£ 925,434	0	0
4 per cent Debenture Stock.....	1,574,566	0	0
		2,500,000	0 0
<b>" Interest accrued on Debenture Stock, less Income Tax.....</b>		27,844	5 11
<b>" Reserve Funds—</b>			
"A" Fund.....	£ 250,000	0	0
"B" Fund.....	450,000	0	0
		700,000	0 0
<b>" Loans on Securities and Deposits.....</b>		100,000	0 0
<b>" Purchases for Future Settlement.....</b>		45,512	15 8
<b>" Sundry Creditors and Credit Balances.....</b>		32,394	1 11
<b>" Unclaimed Interest and Dividends.....</b>		741	1 5
<b>" Dividend for the half-year to 31st March, 1925, on the 4½ per cent Cumulative Preference Stock, less Income Tax.....</b>		21,796	17 6
<b>" Revenue Account—</b>			
Balance brought forward from last year.....	£ 37,107	5	4
Balance for the year to 31st March, 1925.....	£256,159	14	11
Deduct—Dividend on the Preference Stock, less Income Tax.....	43,593	15	0
		212,565	19 11
	£ 249,673	5	3
<b>Less—Amount reserved in respect of Taxation.....</b>	£ 2,000	0	0
<b>Amount applied to extinguish Debenture Stock Rebate and Expenses Account.....</b>	49,485	0	0
<b>Transfer to "B" Reserve Fund</b>	25,000	0	0
<b>Interim Dividend on the Ordinary Stock, paid 1st November, 1924.....</b>	48,437	10	0
		124,922	10 0
		124,750	15 3
<b>NOTE.—The Trust is contingently liable for £148,934 7s. 6d. in respect of Securities held, not fully paid up, and for a sum estimated not to exceed £54,000 in respect of other business.</b>			
		£6,053,039	17 8

## GENERAL TRUST, LIMITED

31ST MARCH, 1925

Cr.

	£	s.	d.
By Investments, including Reserve Fund Investments, at or under cost.....	5,944,879	19	6
" Loans, Advances and Sundry Assets.....	51,569	2	9
" Debenture Stock Rebate and Expenses Account.....	£50,000	0	0
<i>Deduct</i> —Premium on Conversion of 3¼ per cent Debenture Stock.....	£ 515	0	0
Transfer from Revenue Account.....	49,485	0	0
	<u>50,000</u>	<u>0</u>	<u>0</u>
" Sales for Future Settlement.....	4,352	16	6
" Sundry Debtors and Debit Balances.....	3,403	13	5
" Office Fittings and Furniture.....	5,000	0	0
" Cash at Bankers.....	43,834	5	6

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£6,053,039 17 8

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## SECTION

BALANCE SHEET AND PROFIT  
SOCIÉTÉ GÉNÉRALE

## BALANCE SHEET,

## ASSETS

## Non-realizable Assets:

Buildings and Installation.....	Fr.	1,526,432.55
Furniture and Fixtures.....		1.00
Goodwill.....		1.00
Organization Expenses.....		1.00
Premium on Redemption of Bonds and Notes.....		832,500.00
Business under Advise ment.....		589,257.85
Repurchase of Founders' Shares.....		4,000,000.00

## Realizable Assets:

Raw Material.....		2,107,044.30
Stocks and Warehouses.....		1,124,650.32
Various Debtors.....		25,676,930.03
Work in Course of Development.....		23,600,417.30
Portfolio.....	Fr.	28,061,063.41
Less: Shares unpaid for.....		1,888,125.00

Participations.....		15,894,942.29
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## Quick Assets:

Cash and Bank Deposits.....		5,431,537.53
Accounts Receivable.....		557,974.15
Extraordinary Reserve.....		3,700,000.00

Fr. 111,214,627.79

## PROFIT AND LOSS AS PER JUNE 30TH, 1924

DEBIT		CREDIT
General ex- penses and various taxes.....	Fr. 5,430,859.75	Profit on construc- work and various matters. Fr. 16,906,998.01
Coupons on notes and bonds.....	1,493,637.50	Less: Redemp- tion and various items... Fr. 6,163,311.38
Profit for the fiscal year..	3,819,189.38	Fr. 10,743,686.63
	Fr. 10,743,686.63	Fr. 10,743,686.63

## III

AND LOSS ACCOUNT OF  
D'ENTREPRISES (PARIS)

JUNE 30, 1924

## LIABILITIES

Capital.....	Fr. 30,000,000.00
Reserves:	
Legal Reserve.....	1,062,625.40
General Reserve.....	1,800,000.00
Research Funds.....	600,000.00
Special Reserve Fund belonging to Shareholders.....	309,501.49
Premium on Issue of Shares.....	4,550,000.00
Bonded Indebtedness:	
5% Ten-year Notes.....	523,000.00
6% Ten-year Notes.....	6,000,000.00
6% Bonds.....	10,000,000.00
6½% Bonds.....	7,500,000.00
Current:	
Diverse Accounts.....	16,669,445.04
Enterprises in Course of Development.....	4,951,437.04
Accounts Payable.....	18,983,348.70
Coupons to be Paid.....	746,080.74
Extraordinary Reserve.....	3,700,000.00
Profit and Loss 1923-1924.....	3,819,189.38
	<hr/>
	Fr. 111,214,627.79
	<hr/>

## APPENDIX E

### NOTES ON FEDERAL AND STATE TAXES FROM THE STANDPOINT OF THE COMMON LAW AND CORPORATE FORMS OF INVESTMENT TRUST \*

The effect upon property and income of state and federal taxation is of importance both to the investor and promoter, and should be taken into consideration when any business association is organized. Although the problems raised by state taxes are as great as (and in some states greater than) those which result from federal taxation, a discussion of state taxes, with the exception of inheritance taxes, will not be of sufficient general interest to be within the scope of this work.

The first and probably the most important question to be determined is whether or not a given organization is, within the meaning of the federal internal revenue laws, an association or a trust.

Until recently, the Federal Treasury Department held that the distinction between an association and a trust lay in the degree of control which the *cestui que trust* or certificate holders exercised or had the right to exercise over the trustees.<sup>1</sup> On May 12, 1924, the Supreme Court of the United States, in deciding four cases<sup>2</sup> involving Massachusetts trusts, used the following language:

We conclude, therefore, that . . . as the petitioners are not merely trustees for collecting funds and paying them over, but are associated together in much the same manner as the directors in a corporation for the purpose of carrying on business enterprises, the trusts are to be deemed associations . . . ; this being true independently of the large measure of control exercised by the beneficiaries.

As a result of the decision in *Hecht v. Malley* the Treasury Department now holds that the distinction between an association and a trust lies in the purpose of the organization. The latest

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\* By Nathaniel B. Bergman, of the Tax Division of Lybrand, Ross Bros. and Montgomery.

<sup>1</sup> See Montgomery, *Income Tax Procedure*, 1924, pp. 44-48.

<sup>2</sup> *Hecht v. Malley*, *Howard v. Malley*, *Howard v. Casey*, *Crocker v. Malley*, 265 U.S. 144, 44 Sup. Ct. Rep. 462, C. S. L. Ed. 949.



regulations with respect to income taxes and capital stock taxes follow:

The trustees of a majority of investment trusts may, in their discretion, either accumulate income or distribute it. The Revenue Act of 1924 states that the tax imposed by Parts I and II of this title (Income Tax) shall apply to the income of estates or of any kind of property held in trust, including

219. (a) (4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

219. (b) . . . The tax shall be computed upon the net income of the . . . trust and shall be paid by the fiduciary. . . .

(3) In the case of income . . . which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated there shall be allowed as an additional deduction . . . the amount of the income . . . which is properly paid or credited during such year to any . . . beneficiary . . . but the amount so allowed shall be included in computing the net income of the . . . beneficiary.

The regulations issued under the Revenue Act of 1924 (Article 1502, Regulations 65) state:

Associations and joint-stock companies include associations, common-law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. . . .

Treasury Decision 3595 summarizes the position of the government with respect to the question of trusts and it is therefore quoted. The decision has reference to federal capital stock tax, but the underlying principle also applies so far as the income tax is concerned.

(1) Associations—Taxability of Nonstatutory  
Associations — Statutory Construction—  
Revenue Act of 1916.

The capital stock tax imposed by section 407 of the Revenue Act of 1916 upon every corporation, joint-stock company or association, now or hereafter organized in the United States for profit and having a capital stock represented by shares, and every insurance company, now or hereafter organized under the laws of the United States, or any State or Territory, does not

apply to associations which are not organized under any statute, as the language is that used in the Act of 1909, and the words "organized in the United States" have no different effect, as applied to domestic corporations, joint-stock companies and associations, from the word "organized" as used in the Act of 1909. (*Eliot v. Freeman*, 220 U. S. 178 [T. D. 1686] followed.)

## (2) Same—Revenue Act of 1918.

Associations are subject to the capital stock tax imposed by section 1000 (a) of the Revenue Act of 1918, since section 1 of the Act defined "corporations" as including "associations," and the term "domestic" as "created or organized in the United States," a phrase which, in marked contrast with those used in the Acts of 1909 and 1916, extends the tax from one imposed solely upon organizations exercising statutory privileges to include also organizations exercising the privilege of doing business as associations at the common law.

## (3) Massachusetts Trusts—Associations.

The word "association" is used in the Revenue Act of 1918 in its ordinary meaning, and includes "Massachusetts trusts" having quasi corporate organizations under which they are engaged in carrying on business enterprises irrespective of the measure of control vested and exercised by the beneficiaries, as beneficial certificate holders. (*Malley v. Bowditch*, 259 Fed., 809; *Chicago Title Co. v. Smietanka*, 275 Fed. 60 (T. D. 3193 [F. B. 5, 12]) followed; *Crocker v. Malley*, 249 U. S., 223 (T. D. 2816 [not published in Bulletin service] distinguished.)

## (4) Capital Stock—Average Value.

The capital stock tax is based upon the average value of capital stock, including surplus and undivided profits. These words are not to be given a technical meaning, but, interpreted in their entirety, are equivalent to the capital invested in the business—that is, the net value of the property owned and used in the business.

If the trust is taxable as an association, federal capital stock will have to be paid:

Two distinct classes of trusts are recognized, namely, holding trusts and operating trusts.

Holding trusts are those in which the trustees are merely holding property for the collection of the income and distributing it among the beneficiaries and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business. Such trusts are not associations within the meaning of the law and are not subject to the tax.

Operating trusts are those in which the trustees are not restricted to the mere collection of funds and paying them over to the beneficiaries but are associated together in much the same manner as directors in a corporation

for the purpose of, and are actually engaged in, carrying on some business enterprise. These trusts, whether of the Massachusetts type or otherwise, are to be deemed associations within the meaning of the act, independently of any control exercised by the beneficiaries, and subject to the tax. (Art. 8, Reg. 64.)

In earlier tax laws, the question arose whether the Massachusetts trust was an ordinary trust or an association. In the following ruling, which was undoubtedly based on the erroneous interpretation of *Crocker v. Malley*, hereinbefore mentioned, the answer depended upon whether the beneficiaries had a voice in the business:

Where beneficiaries holding certificates evidencing their interest under a so-called "Massachusetts trust" agreement annually elect persons delegated to conduct the affairs of the trusts, thus retaining a voice in the business, the trust is an association and is subject to the normal tax upon its income under the Acts of 1913, 1916, and 1918; the excess profits tax under the Acts of 1917 and 1918; the capital stock tax under the Acts of 1916 and 1918; and the certificates issued by the trust to the beneficiaries are subject to the stamp tax under the Acts of 1917 and 1918.

Where the trustees originally appointed were to hold office during the entire period of the trust, the right of the shareholders being limited to filling vacancies, the beneficiaries not retaining any substantial control over the affairs of the trust, such a trust is not an association or taxable as such under section 230 of the Act of 1918, but under section 219 relating to trusts. They are not subject to the excess profits tax nor the capital stock tax, nor are the certificates issued by the trustees subject to stamp tax. (C.B. 1, page 5; S. 1068.)

The rights of the states to tax trusts are involved with a great mass of opinion on the subject.

The word "association" as used in the Blue Sky Laws (C. S. Sec. 5305, as amended by Laws 1921, C. 20) should be construed to include a common-law trust. (*State v. Cosgrove*, 36 Idaho—210 P. 393.)

A state can only tax property or persons within its jurisdiction.

Under Article 9A of the New York State franchise tax law "The term corporation includes a joint stock company or association and any business conducted by a trustee or trustees wherein interest ownership is evidenced by certificate or other written instrument."

From the foregoing, it is apparent that if an investment trust is a "holding trust" it is taxed as a trust, if an "operating trust," it is taxed as an association.

If an organization is an association it is subject to the corporation income tax of  $12\frac{1}{2}$  per centum of its net taxable income. If, however, any part of the income is derived from dividends or stocks of domestic corporations, such part is not subject to the corporation income tax. All distributions to *cestui que trust* or certificate holders are taxable to them at surtax rates, but are exempt from the normal income tax imposed upon individuals.

An association, like a corporation, is subject to the provisions of section 220 of the Revenue Act of 1924. In other words, if it is organized or availed of for the purpose of avoiding the imposition of the surtax by allowing its income to accumulate beyond reasonable needs, it is subject to a tax of fifty per centum of its net income in addition to the ordinary corporate income tax of  $12\frac{1}{2}$  per cent.

An association is also subject to the federal capital stock tax. This excise is paid for the privilege of doing business and is at the rate of one dollar for each one thousand dollars of the fair value of its capital stock.

An association must pay at the time it originally issues shares of stock or beneficial interest a stamp tax of five cents for each \$100 of par value, or fraction thereof, of its stock. If the stock is of no par value, the tax is at the rate of five cents for each \$100 or fraction thereof of actual value, unless the actual value is less than \$100, in which case the tax is one cent for each \$20 or fraction thereof of actual value.

Upon the sale or transfer of shares of an association, a stamp tax equal to two cents on each \$100 of face value or fraction thereof sold or transferred must be paid. If the shares are of no par value, the tax is imposed at the rate of two cents for each share sold or transferred.

If the organization is a "holding trust" as hereinbefore defined, it is not taxable as an association. The trustees of most investment trusts may, in their discretion, either distribute income or accumulate it. Section 219 (b-3) of the Revenue Act of 1924 provides that under such circumstances, that part of the income which is distributed shall be taxable to the distributees and that that part which is accumulated shall be taxable to the trust as an entity. Regardless of whether the trust or the beneficiaries pay the tax,

the income is subject to surtax and except to the extent derived from dividends on stocks of domestic corporations and from interest on certain obligations of the United States, is also subject to the normal tax imposed upon individuals. To the extent that a holding trust is taxable it is treated as an individual.

If under the terms of the trust deed the trustees are required to distribute any part of the income currently, such part is taxable to the beneficiaries whether actually distributed or not.



## APPENDIX F

### REGULATIONS OF THE FEDERAL RESERVE BOARD CONCERNING THE APPLICATION OF THE EDGE ACT

(See Chapter II)

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#### "EDGE ACT"

REGULATION K, SERIES OF 1924

FEDERAL RESERVE BOARD

(Superseding Regulation K of 1923)

BANKING CORPORATIONS AUTHORIZED TO DO FOREIGN BANKING BUSINESS  
UNDER THE TERMS OF SECTION 25 (a) OF THE FEDERAL RESERVE ACT

#### SECTION I.—*Organization*

Any number of natural persons, not less in any case than five, may form a Corporation\* under the provisions of section 25(a) for the purpose of engaging in international or foreign banking or other international or foreign financial operations or in banking or other financial operations in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries or in such dependencies or insular possessions.

#### SECTION II.—*Articles of Association*

Any persons desiring to organize a corporation for any of the purposes defined in section 25(a) shall enter into articles of association (see F. R. B. Form 151 which is suggested as a satisfactory form of articles of association) which shall specify in general terms the objects for which the Corporation is formed, and may contain any other provisions not inconsistent with law which the Corporation may see fit to adopt for the regulation of its business and the conduct of its affairs. The articles of association shall be signed by

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\* Whenever these regulations refer to a corporation spelled with a capital C, they relate to a corporation organized under section 25 (a) of the Federal reserve act.

each person intending to participate in the organization of the Corporation and when signed shall be forwarded to the Federal Reserve Board in whose office they shall be filed.

### SECTION III.—*Organization Certificate*

All of the persons signing the articles of association shall under their hands make an organization certificate on F. R. B. Form 152, which is made a part of this regulation, and which shall state specifically:

First. The name assumed by the Corporation.

Second. The place or places where its operations are to be carried on.

Third. The place in the United States where its home office is to be located.

Fourth. The amount of its capital stock and the number of shares into which it shall be divided.

Fifth. The names and places of business or residences of persons executing the organization certificate and the number of shares to which each has subscribed.

Sixth. The fact that the certificate is made to enable the persons subscribing the same and all other persons, firms, companies, and corporations who or which may thereafter subscribe to or purchase shares of the capital stock of such Corporation to avail themselves of the advantages of this section.

The persons signing the organization certificate shall acknowledge the execution thereof before a judge of some court of record or notary public who shall certify thereto under the seal of such court or notary. Thereafter the certificate shall be forwarded to the Federal Reserve Board to be filed in its office.

### SECTION IV.—*Title*

Inasmuch as the name of the Corporation is subject to the approval of the Federal Reserve Board, a preliminary application for that approval should be filed with the Federal Reserve Board on F. R. B. Form 150, which is made a part of this regulation. This application should state merely that the organization of a Corporation under the proposed name is contemplated and may request the approval of that name and its reservation for a period of 30 days. No Corporation which issues its own bonds, debentures, or other such obligations will be permitted to have the word "bank" as a part of its title. No Corporation which has the word "Federal" in its title will be permitted also to have the word "bank" as a part of its title. So far as possible the title of the Corporation should indicate the nature or reason of the business contemplated and should in no case resemble the name of any other corporation to the extent that it might result in misleading or deceiving the public as to its identity, purpose, connections, or affiliations.

SECTION V.—*Authority to commence business*

After the articles of association and organization certificate have been made and filed with the Federal Reserve Board, and after they have been approved by the Federal Reserve Board and a preliminary permit to begin business has been issued by the Federal Reserve Board, the association shall become and be a body corporate, but none of its powers except such as are incidental and preliminary to its organization shall be exercised until it has been formally authorized by the Federal Reserve Board by a final permit generally to commence business.

Before the Federal Reserve Board will issue its final permit to commence business, the president or cashier, together with at least three of the directors, must certify (a) that each director elected is a citizen of the United States; (b) that a majority of the shares of stock is owned by citizens of the United States, by corporations the controlling interest in which is owned by citizens of the United States chartered under the laws of the United States, or by firms or companies the controlling interest in which is owned by citizens of the United States; and (c) that of the authorized capital stock specified in the articles of association at least 25 per cent has been paid in in cash and that each shareholder has individually paid in in cash at least 25 per cent of his stock subscription. Thereafter the cashier shall certify to the payment of the remaining installments as and when each is paid in, in accordance with law.

SECTION VI.—*Capital stock*

No Corporation may be organized under the terms of section 25(a) with a capital stock of less than \$2,000,000. The par value of each share of stock shall be specified in the articles of association, and no Corporation will be permitted to issue stock of no par value. If there is more than one class of stock, the name and amount of each class and the obligations, rights, and privileges attaching thereto shall be set forth fully in the articles of association. Each class of stock shall be so named as to indicate to the investor as nearly as possible what is its character and to put him on notice of any unusual attributes.

SECTION VII.—*Transfer of stock*

Section 25 (a) provides in part that—

A majority of the shares of the capital stock of any such corporation shall at all times be held and owned by the citizens of the United States, by corporations the controlling interest in which is owned by citizens of the United States, chartered under the laws of the United States or of a State of the United States, or by firms or companies the controlling interest in which is owned by citizens of the United States.

In order to insure compliance at all times with the requirements of this provision after the organization of the Corporation, shares of stock shall be

issuable and transferable only on the books of the Corporation. Every application for the issue or transfer of stock shall be accompanied by an affidavit of the party to whom it is desired to issue or transfer stock, or by his or its duly authorized agent, stating—

**In the case of an individual.**—(a) Whether he is or is not a citizen of the United States and, if a citizen of the United States, whether he is a natural-born citizen or a citizen by naturalization, and if naturalized, whether he remains for any purpose in the allegiance of any foreign sovereign or State; (b) whether there is or is not any arrangement under which he is to hold the shares or any of the shares which he desires to have issued or transferred to him, in trust for or in any way under the control of any foreign State or any foreigner, foreign corporation, or any corporation under foreign control; and if so, the nature thereof.

**In the case of a corporation.**—(a) Whether such corporation is or is not chartered under the laws of the United States or of a State of the United States. If it is not, no further declaration is necessary, but if it is, it must also be stated (b) whether the controlling interest in such corporation is or is not owned by citizens of the United States, and (c) whether there is or is not any arrangement under which such corporation will hold the shares or any of the shares if issued or transferred to such corporation in trust for or in any way under the control of any foreign State or any foreigner or foreign corporation or any corporation under foreign control; and if so, the nature thereof.

**In the case of a firm or company.**—(a) Whether the controlling interest in such firm or company is or is not owned by citizens of the United States; and if so, (b) whether there is or is not any arrangement under which such firm or company will hold the shares or any of the shares if issued or transferred to such firm or company in trust for or in any way under the control of any foreign State or any foreigner or foreign corporation or any corporation under foreign control; and if so, the nature thereof.

The board of directors of the Corporation, whether acting directly or through an agent, may, before making any issue or transfer of stock, require such further evidence as in their discretion they may think necessary in order to determine whether or not the issue or transfer of the stock would result in a violation of the law. No issue or transfer of stock which would cause 50 per cent or more of the total amount of stock issue or outstanding to be held contrary to the provisions of the law or these regulations shall be made upon the books of the Corporation. The decision of the board of directors in each case shall be final and conclusive and not subject to any question by any person, firm, or corporation on any ground whatsoever.

If at any time by reason of the fact that the holder of any shares of the Corporation ceases to be a citizen of the United States, or, in the opinion of the board of directors, becomes subject to the control of any foreign State or foreigner or foreign corporation or corporation under foreign control, 50 per cent or more of the total amount of capital stock issued or outstanding is

held contrary to the provisions of the law or these regulations, the board of directors may, when apprised of that fact, forthwith serve on the holder of the shares in question a notice in writing requiring such holder within two months to transfer such shares to a citizen of the United States, or to a firm, company, or corporation approved by the board of directors as an eligible stockholder. When such notice has been given by the board of directors the shares of stock so held shall cease to confer any vote until they have been transferred as required above; and if on the expiration of two months after such notice the shares shall not have been so transferred, the shares shall be forfeited to the Corporation.

The board of directors shall prescribe in the by-laws of the Corporation appropriate regulations for the registration of the shares of stock in accordance with the terms of the law and these regulations. The by-laws must also provide that the certificates of stock issued by the Corporation shall contain provisions sufficient to put the holder on notice of the terms of the law and the regulations of the Federal Reserve Board defining the limitations upon the rights of transfer.

#### SECTION VIII.—*Operations in the United States*

No Corporation shall carry on any part of its business in the United States except such as shall be incidental to its international or foreign business. Agencies may be established in the United States with the approval of the Federal Reserve Board for specific purposes, but not generally to carry on the business of the Corporation.

#### SECTION IX.—*Investments in the stock of other corporations*

It is contemplated by the law that a Corporation shall conduct its business abroad either directly or indirectly through the ownership or control of corporations, and it is accordingly provided that with the consent of the Federal Reserve Board a Corporation may invest in the stock, or other certificates of ownership, of any other corporation organized—

(a) Under the provisions of section 25 (a) of the Federal reserve act;  
(b) Under the laws of any foreign country or a colony or dependency thereof;

(c) Under the laws of any State, dependency, or insular possession of the United States;  
provided, first, that such other corporation is not engaged in the general business of buying or selling goods, wares, merchandise, or commodities in the United States; and second, that it is not transacting any business in the United States except such as is incidental to its international or foreign business.

Except with the approval of the Federal Reserve Board, no Corporation shall invest an amount in excess of 15 per cent of its capital and surplus in the



stock of any corporation engaged in the business of banking, or an amount in excess of 10 per cent of its capital and surplus in the stock of any other kind of corporation.

No Corporation shall purchase any stock in any other corporation organized under the terms of section 25(a) or under the laws of any State, which is in substantial competition therewith, or which holds stock or certificates of ownership in corporations which are in substantial competition with the purchasing Corporation. This restriction, however, does not apply to corporations organized under foreign laws.

#### SECTION X.—*Branches*

No Corporation shall establish any branches except with the approval of the Federal Reserve Board, and in no case shall any branch be established in the United States.

#### SECTION XI.—*Issue of debentures, bonds, and promissory notes*

**Approval of the Federal Reserve Board.**—No Corporation shall make any public or private issue of its debentures, bonds, notes, or other such obligations without the approval of the Federal Reserve Board, but this restriction shall not apply to notes issued by the Corporation in borrowing from banks or bankers for temporary purposes not to exceed one year. The approval of the Federal Reserve Board will be based solely upon the right of the Corporation to make the issue under the terms of this regulation and shall not be understood in any way to imply that the Federal Reserve Board has approved or passed upon the merits of such obligations as an investment. The Federal Reserve Board will consider the general character and scope of the business of the Corporation in determining the amount of debentures, bonds, notes, or other such obligations of the Corporation which may be issued by it.

**Application.**—Every application for the approval of any such issue by a Corporation shall be accompanied by (1) a statement of the condition of the Corporation in such form and as of such date as the Federal Reserve Board may require; (2) a detailed list of the securities by which it is proposed to secure such issue, stating their maturities, indorsements, guaranties, or collateral, if any, and in general terms the nature of the transaction or transactions upon which they were based; and (3) such other data as the Federal Reserve Board may from time to time require.

**Advertisements.**—No circular, letter, or other document advertising the issue of the obligations of a Corporation shall state or contain any reference to the fact that the Federal Reserve Board has granted its approval of the issue to which the advertisement relates. This requirement will be enforced strictly in order that there may be no possibility of the public's misconstruing such a reference to be an approval by the Federal Reserve Board of the merits or desirability of the obligations as an investment.

SECTION XII.—*Sale of foreign securities*

**Approval of the Federal Reserve Board.**—No Corporation shall offer for sale any foreign securities with its indorsement or guaranty, except with the approval of the Federal Reserve Board, but such approval will be based solely upon the right of the Corporation to make such a sale under the terms of this regulation and shall not be understood in any way to imply that the Federal Reserve Board has approved or passed upon the merits of such securities as an investment.

**Application.**—Every application for the approval of such sale shall be accompanied by a statement of the character and amount of the securities proposed to be sold, their indorsements, guaranties, or collateral, if any, and such other data as the Federal Reserve Board may from time to time require.

**Advertisements.**—No circular, letter, or other document advertising the sale of foreign securities by a Corporation with its indorsement or guaranty shall state or contain any reference to the fact that the Federal Reserve Board has granted its approval of the sale of the securities to which the advertisement relates.

SECTION XIII.—*Acceptances*

**Kinds.**—Any Corporation may accept (1) drafts and bills of exchange drawn upon it which grow out of transactions involving the importation or exportation of goods, and (2) drafts and bills of exchange which are drawn by banks or bankers located in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in such countries, dependencies, and possessions: *Provided, however,* That, except with the approval of the Federal Reserve Board and subject to such limitations as it may prescribe, no Corporation shall exercise its power to accept drafts or bills of exchange if at the time such drafts or bills are presented for acceptance it has outstanding any debentures, bonds, notes, or other such obligations issued by it.

**Maturity.**—Except with the approval of the Federal Reserve Board, no Corporation shall accept any draft or bill of exchange which grows out of a transaction involving the importation or exportation of goods with a maturity in excess of six months, or shall accept any draft or bill of exchange drawn for the purpose of furnishing dollar exchange with a maturity in excess of three months.

**Limitations.**—(1) Individual drawers: No acceptances shall be made for the account of any one drawer in an amount aggregating at any time in excess of 10 per cent of the subscribed capital and surplus of the Corporation, unless the transaction be fully secured or represents an exportation or importation of commodities and is guaranteed by a bank or banker of undoubted solvency. (2) Aggregates: Whenever the aggregate of acceptances outstanding at any

time (a) exceeds the amount of the subscribed capital and surplus, 50 per cent of all the acceptances in excess of the amount shall be fully secured; or (b) exceeds twice the amount of the subscribed capital and surplus, all the acceptances outstanding in excess of such amount shall be fully secured. (The Corporation shall elect whichever requirement (a) or (b) calls for the smaller amount of secured acceptances.) In no event shall any Corporation have outstanding at any one time acceptances drawn for the purpose of furnishing dollar exchange in an amount aggregating more than 50 per cent of its subscribed capital and surplus.

**Reserves.**—Against all acceptances outstanding which mature in 30 days or less a reserve of at least 15 per cent shall be maintained, and against all acceptances outstanding which mature in more than 30 days a reserve of at least 3 per cent shall be maintained. Reserves against acceptances must be in liquid assets of any or all of the following kinds: (1) Cash; (2) balances with other banks; (3) bankers' acceptances; and (4) such securities as the Federal Reserve Board may from time to time permit.

#### SECTION XIV.—*Deposits*

**In the United States.**—No Corporation shall receive in the United States any deposits except such as are incidental to or for the purpose of carrying out transactions in foreign countries or dependencies of the United States where the Corporation has established agencies, branches, correspondents, or where it operates through the ownership or control of subsidiary corporations. Deposits of this character may be made by individuals, firms, banks, or other corporations, whether foreign or domestic, and may be time deposits or on demand.

**Outside the United States.**—Outside the United States a Corporation may receive deposits of any kind from individuals, firms, banks, or other corporations, provided, however, that if such corporation has any of its bonds, debentures, or other such obligations outstanding it may receive abroad only such deposits as are incidental to the conduct of its exchange, discount, or loan operations.

**Reserves.**—Against all deposits received in the United States a reserve of not less than 13 per cent must be maintained. This reserve may consist of cash in vault, a balance with the Federal reserve bank of the district in which the head office of the Corporation is located, or a balance with any member bank. Against all deposits received abroad the Corporation shall maintain such reserves as may be required by local laws and by the dictates of sound business judgment and banking principles.

#### SECTION XV.—*General limitations and restrictions*

**Liabilities of one borrower.**—The total liabilities to a Corporation of any person, company, firm, or corporation for money borrowed, including in the

liabilities of a company or firm the liabilities of the several members thereof, shall at no time exceed 10 per cent of the amount of its subscribed capital and surplus, except with the approval of the Federal Reserve Board: *Provided, however,* That the discount of bills of exchange drawn in good faith against actually existing values and the discount of commercial or business paper actually owned by the person negotiating the same shall not be considered as money borrowed within the meaning of this paragraph. The liability of a customer on account of an acceptance made by the Corporation for his account is not a liability for money borrowed within the meaning of this paragraph unless and until he fails to place the Corporation in funds to cover the payment of the acceptance at maturity or unless the Corporation itself holds the acceptance.

**Aggregate liabilities of the Corporation.**—The aggregate of the Corporation's liabilities outstanding on account of acceptances, average domestic and foreign deposits, debentures, bonds, notes, guaranties, indorsements, and other such obligations shall not exceed at any one time ten times the amount of the Corporation's subscribed capital and surplus except with the approval of the Federal Reserve Board. In determining the amount of the liabilities within the meaning of this paragraph, indorsements of bills of exchange having not more than six months to run, drawn and accepted by others than the Corporation, shall not be included.

**Operations abroad.**—Except as otherwise provided in the law and these regulations, a Corporation may exercise abroad not only the powers specifically set forth in the law but also such incidental powers as may be usual in the determination of the Federal Reserve Board in connection with the transaction of the business of banking or other financial operations in the countries in which it shall transact business. In the exercise of any of these powers abroad a Corporation must be guided by the laws of the country in which it is operating and by sound business judgment and banking principles.

#### SECTION XVI.—*Management*

The directors, officers, or employees of a Corporation shall exercise their rights and perform their duties as directors, officers, or employees, with due regard to both the letter and the spirit of the law and these regulations. For the purpose of these regulations the Corporation shall, of course, be responsible for all acts of omission or commission of any of its directors, officers, employees, or representatives in the conduct of their official duties. The character of the management of a Corporation and its general attitude toward the purpose and spirit of the law and these regulations will be considered by the Federal Reserve Board in acting upon any application made under the terms of these regulations.

#### SECTION XVII.—*Reports and examinations*

**Reports.**—Each Corporation shall make at least two reports annually to the Federal Reserve Board at such times and in such form as it may require.

**Examinations.**—Each Corporation shall be examined at least once a year by examiners appointed by the Federal Reserve Board. The cost of examinations shall be paid by the Corporation examined.

SECTION XVIII.—*Amendments to regulations*

These regulations are subject to amendment by the Federal Reserve Board from time to time, provided, however, that no such amendment shall prejudice obligations undertaken in good faith under regulations in effect at the time they were assumed.



## APPENDIX G

### THE LONDON FINANCIAL TIMES (1925) ANALYSIS OF CAPITAL EARNINGS, DIVIDENDS AND RESERVES OF LEADING ENGLISH AND SCOTTISH INVESTMENT TRUSTS

#### I

#### BRITISH INVESTMENT TRUST COMPANIES

(Compiled for "*The Financial Times*" of London, with the following explanatory statement)

Below will be found a comprehensive table compiled from the latest reports issued by 23 representative English trust companies with a total issued capital of £51,663,231.

The past twelve months again show steady progress, and the aggregate gross income, less income-tax, etc., amounts to £3,115,875, or 6.03 per cent on the capital employed, against £2,848,313, or 5.66 per cent, in the preceding year, an improvement of £267,562, or .37 per cent. This has been accomplished at the same low ratio of expenses to which reference was made last year.

After payment of management expenses, debenture interest, preference dividends, etc., the surplus revenue available in respect of the ordinary stock outstanding amounts to £1,647,297, against £1,435,209 last year; an increase of £212,088, or .97 per cent.

This improvement is reflected in the payment of larger dividends by nearly all the companies, such increases varying from  $\frac{1}{2}$  per cent up to 2 per cent. The total aggregate net amount paid to the ordinary shareholders this year is £1,174,993, or an average of 7.72 per cent, against £1,054,090, or 7.24 per cent, for the preceding period.

The margin of safety represented by the surplus remaining over, after payment of the ordinary dividends, amounts to £472,304, or 3.11 per cent, so that the risk of any reduction in the present rates of dividends paid appears to be strongly guarded against.

The progressive character of these extremely well managed companies has not only resulted in the payment of steadily increasing dividends during the past few years but has also permitted of the transfer from revenue of considerable sums to reserves and/or in the writing down of the cost of investments.

The reserves and amounts carried forward of the table total £6,686,962, an amount equal to 43.96 per cent on the £15,211,495 ordinary stock issued.

The safe investment of money at good yields is by no means an easy problem, but becomes more of an exact science with an investment trust com-

pany than with the average individual whose capital is limited and to whom mistakes may be serious.

In spite of all the care exercised when making investments where it is sought to combine high rates of interest with good security no one can help making mistakes at times, but in the case of investment trust companies only a comparatively small portion of their total funds is placed in any one security, while their holdings are widely spread over a number of the different 23 representative companies comprised in countries and in various kinds of investments. Consequently, the influences which were responsible for loss in one country or in one class of security may also be responsible for improvement in other countries or in some other class of security, and in the main the accounts submitted prove a balance well on the right side.

We have recently witnessed the flotation of a number of new investment trust companies, as well as the issue of fresh capital by some of the older ones at a substantial premium, from which it may be inferred that there is no lack of capital for investment in this class of security.

The private investor is undoubtedly beginning to realise more and more the advantage of placing his money in the securities of the investment trust companies, where not only satisfactory dividends can be counted on, even in bad times, but where the risk of loss of capital, inherent to any business, is reduced to a minimum through the sound distribution of risk, both geographically and in the varied nature of the investments held.

The debenture stocks of the best investment trust companies may be regarded as very nearly, if not quite, as safe as trustee securities, and their yield, at present current prices, is about 5 to  $5\frac{1}{4}$  per cent. The Preference stocks will recommend themselves to the conservative mind as very sound fixed dividend-paying investments, yielding  $5\frac{1}{4}$  to  $5\frac{1}{2}$  per cent and, in one or two cases, as much as about 6 per cent.

The yield on the ordinary stocks given in the table varies between 5 per cent in the case of the Metropolitan Trust Company and 7.41 per cent for the Charter Trust and Agency, Ltd.

In considering the low rate of return on certain of these stocks, the surplus remaining over, after payment of the dividends, pointing to the possibility of future increased rates, must be taken into account, as also that in some cases new capital was only received gradually during the year, and therefore did not become fully productive, anticipated future benefits being reflected in prices.

The ordinary stocks can be looked upon as most suitable for the intelligent man who requires a well-secured investment offering a fair yield, coupled with a good chance of appreciation in capital value.

It has been pointed out previously in THE FINANCIAL TIMES that some difficulty may be experienced in acquiring these ordinary stocks, and, conversely, the ease with which sales may be effected. Those desiring to invest money in these stocks will best serve their purpose by leaving their orders with brokers or agents for execution as opportunity offers, without tying the agents down to the ordinary stock of any one particular company.

	COMPANY	YEAR	CAPITAL ISSUED			
			Debenture	Preference	Ordinary	Total
			£	£	£	£
1	American Investment and General Trust Co., Ltd.	1924/25	1,000,000	500,000	500,000	2,000,000
		1923/24	1,000,000	500,000	500,000	2,000,000
2	Army and Navy Investment Trust Co., Ltd.	1923/24	400,000	360,000	200,000	960,000
		1922/23	400,000	360,000	200,000	960,000
3	Bankers' Investment Trust, Ltd.	1924/25	900,000	900,000	900,000	2,700,000
		1923/24	900,000	900,000	900,000	2,700,000
4	Charter Trust and Agency, Ltd.	1923/24	89,670	500,000	500,000	1,089,670
		1922/23	90,770	500,000	500,000	1,090,770
5	Foreign, American, and General Investments Trust Co., Ltd.	1924/25	500,000	750,000	750,000	2,000,000
		1923/24	500,000	750,000	750,000	2,000,000
6	Foreign and Colonial Investment Trust Co., Ltd.	1924/25	—	1,249,991 15/-	1,106,755 10/-	2,356,747 5/-
		1923/24	—	1,249,991 15/-	1,106,755 10/-	2,356,747 5/-
7	General and Commercial Investment Trust, Ltd.	1924/25	300,000	300,000	300,000	900,000
		1923/24	300,000	300,000	300,000	900,000
8	General Investors and Trustees, Ltd.	1924/25	200,000	300,000	300,000	800,000
		1923/24	200,000	300,000	300,000	800,000
9	Government Stock and Other Securities Investment Co., Ltd.	1924	925,000	462,500	462,500	1,850,000
		1923	925,000	462,500	462,500	1,850,000
10	Guardian Investment Trust Co., Ltd.	1924/25	500,000	310,000	310,000	1,120,000
		1923/24	500,000	310,000	310,000	1,120,000
11	Industrial and General Trust, Ltd.	1924/25	2,500,000	1,250,000	1,250,000	5,000,000
		1923/24	2,500,000	1,250,000	1,250,000	5,000,000
12	International Investment Trust, Ltd.	1924/25	750,000	600,000	400,000	1,750,000
		1923/24	750,000	600,000	400,000	1,750,000
		1924/25	2,300,000	1,200,000	300,000	4,600,000
13	Investment Trust Corporation, Ltd.			New Shares	300,000	
		1923/24	2,000,000	1,800,000	300,000	4,000,000
14	London and New York Investment Corp., Ltd.	1923/24	150,000	434,500	100,000	684,500
		1922/23	150,000	434,500	100,000	684,500
15	London Scottish American Trust, Ltd.	1923/24	632,197	500,000	500,000	1,632,197
		1922/23	632,197	500,000	500,000	1,632,197
16	London Trust Co., Ltd.	1924/25	937,856	570,000	480,000	1,987,856
		1923/24	937,856	525,000	375,000	1,837,856
17	Mercantile Investment and General Trust Co., Ltd.	1924/25	3,000,000	1,500,000	1,500,000	6,000,000
		1923/24	3,000,000	1,500,000	1,500,000	6,000,000
18	Merchants Trust, Ltd.	1924/25	1,330,000	687,500	687,500	2,705,000
		1923/24	1,330,000	687,500	687,500	2,705,000
		1924/25	1,000,000	400,000	400,000	2,000,000
19	Metropolitan Trust Co., Ltd.			New Shares	200,000	
		1923/24	800,000	400,000	400,000	1,600,000
20	Omnium Investment Co., Ltd.	1924	829,480	414,740	414,740	1,658,960
		1923	771,956	414,740	414,740	1,601,436
21	Sterling Trust, Ltd.	1924	2,607,893	—	1,250,000	3,857,893
		1923	2,607,893	—	1,250,000	3,857,893
22	United States and South American Investment Trust Co., Ltd.	1924/25	810,408	500,000	500,000	1,810,408
		1923/24	806,807	500,000	500,000	1,806,807
		1924/25	—	1,100,000	1,100,000	2,200,000
23	Witan Investment Co., Ltd.	1923/24	—	1,050,000	1,050,000	2,100,000
	Summary	1924/25	£21,662,504	14,789,231 15/-	15,211,495 10/-	51,663,231 5/-
	Summary	1923/24	£21,102,479	14,694,231 15/-	14,566,495 10/-	50,353,206 5/-
	Increase	—	£560,025	95,000	655,000	1,310,025

## TRUST COMPANIES

Company	Gross Revenue, less Income Tax, etc.	% on Capital	Ex-penses	% on Capital	Debenture Interest, Preference Dividends etc. (less tax)	ORDINARY STOCK						Reserves and Carry Forward	% on Ordinary Stock
						Balance Revenue Available	%	Amount Paid	%	Surplus for Year	%		
	£		£		£	Net.	Gross.	Net.	Gross.	£	Gross.	£	
1	119,135	5.96	6,112	.31	51,488	61,535	15.88	46,500	12	15,035	3.88	389,421	77.88
2	112,178	5.61	6,041	.30	51,700	54,437	14.07	42,646	11	11,891	3.07	360,494	73.30
	64,147	6.68	4,589	.48	26,350	33,208	21.42	18,600	12	14,608	9.42	240,896	120.45
3	58,484	6.08	4,387	.46	26,209	27,828	18.15	16,860	11	10,968	7.15	238,246	119.12
	153,129	5.67	9,675	.36	59,718	83,736	11.97	59,474	8 1/2	24,262	3.47	165,350	18.37
4	139,077	5.15	8,498	.31	69,331	71,243	10.21	62,312	7 1/2	18,936	2.71	125,637	13.96
	49,628	4.55	7,305	.67	22,502	19,821	5.12	19,375	5	446	.12	55,442	11.09
5	47,717	4.38	7,312	.67	22,309	18,096	4.72	17,271	4 1/2	825	.22	54,997	11.00
	112,301	5.62	6,290	.31	44,628	61,383	10.56	43,594	7 1/2	17,789	3.06	180,556	24.07
6	102,919	5.15	6,344	.32	44,687	51,888	8.94	40,612	7	11,276	1.94	185,629	24.75
	136,710	5.80	9,431	.40	48,447	78,832	9.19	64,330	7 1/2	14,502	1.69	781,000	70.57
7	124,370	5.28	8,836	.37	48,271	67,263	7.90	59,590	7	7,673	.30	780,992	70.57
	51,265	5.67	6,336	.70	20,925	24,004	10.32	23,250	10	754	.32	131,372	43.79
8	47,143	5.24	6,336	.70	20,864	19,943	8.60	19,709	8 1/2	234	.10	130,681	43.53
	84,681	10.59	16,074	2.01	16,662	51,945	22.34	20,925	9	31,020	13.34	179,750	59.92
9	64,458	8.06	12,794	1.60	16,545	36,119	15.19	18,499	8	16,680	7.19	160,730	60.24
	98,718	5.34	9,407	.51	49,713	39,598	11.05	28,675	8	10,923	3.05	118,860	25.70
10	92,386	4.99	9,238	.50	49,336	38,812	9.51	28,444	8	5,368	1.61	107,937	23.34
	64,193	5.73	4,404	.39	26,311	33,478	13.93	24,025	10	9,453	3.93	12,000	3.87
11	60,864	5.43	3,898	.35	26,135	30,837	12.92	21,477	9	9,360	3.92	12,000	3.87
	360,707	7.21	32,635	.65	117,505	210,567	21.74	135,625	14	74,942	7.74	737,563	59.01
12	296,479	5.93	30,826	.62	106,062	159,691	17.13	116,444	12 1/2	43,147	4.65	712,107	56.97
	87,035	4.97	8,312	.47	44,175	34,548	11.14	21,700	7	12,848	4.14	492	.12
13	83,896	4.79	7,664	.44	43,986	32,306	10.48	18,600	6	13,806	4.48	12,644	3.16
	269,371	5.86	14,791	.32	105,332	149,248	24.01	118,117	19	31,131	5.01	1,063,398	132.92
14	245,596	6.14	11,995	.30	99,200	134,401	21.68	105,400	17	29,001	4.68	861,239	107.65
	42,020	6.14	3,101	.45	22,329	16,590	21.41	6,200	8	10,390	13.41	112,393	112.39
15	39,213	5.73	3,035	.44	22,092	14,086	18.42	7,646	10	6,440	8.42	102,002	102.00
	94,647	5.80	10,032	.61	37,036	47,579	12.28	38,750	10	8,829	2.28	331,674	66.33
16	99,320	6.47	10,111	.62	36,538	42,671	11.16	34,406	9	8,265	2.16	321,646	64.83
	127,887	6.43	11,504	.58	53,348	63,035	16.94	46,500	12 1/2	16,535	4.44	167,924	34.98
17	117,135	6.38	10,011	.54	50,704	56,470	19.43	34,876	12	21,596	7.43	302,036	80.64
								and Stock Bonus 40%					
18	360,349	6.01	15,453	.26	154,026	190,870	16.42	139,499	12	51,371	4.42	532,919	35.53
	340,560	5.63	15,882	.26	153,197	171,481	14.83	121,406	10 1/2	50,075	4.33	481,648	32.10
19	151,074	5.58	12,500	.46	62,543	76,031	14.27	68,609	11	17,422	3.27	368,593	53.61
	139,335	5.15	12,500	.46	61,874	84,961	12.26	52,995	10	11,966	2.26	363,093	52.81
20	128,758	6.44	8,596	.43	48,557	71,605	23.10	54,250	17 1/2	17,355	5.60	605,112	151.28
						on £400,000	Ord.Stk	on £400,000	Ord.Stock	on £400,000	Ord.St.	on £400,000	Ord.St.
21	108,629	6.79	7,530	.47	38,437	62,662	20.38	49,200	16	13,462	4.38	511,395	127.85
	81,159	4.89	8,769	.53	45,047	27,343	8.51	25,714	8	1,629	.51	60,018	14.47
22	83,866	5.24	8,650	.54	44,254	30,962	9.71	25,507	8	5,455	1.71	58,589	14.08
	212,082	5.50	10,199	.26	101,056	100,827	10.41	72,656	7 1/2	28,171	2.91	180,886	14.47
23	199,193	5.16	10,303	.27	99,866	99,099	9.27	67,266	7	2,763	.27	152,715	12.22
	104,741	5.79	5,744	.32	45,242	53,755	13.87	38,750	10	15,005	3.87	99,769	19.95
24	100,553	5.67	5,618	.31	45,163	49,782	12.85	34,875	9	14,907	3.85	84,764	16.95
	162,138	7.37	6,888	.31	37,491	117,759	14.14	69,875	6 1/2 free = 8.39 gross	47,884	5.75	171,574	16.51
25	154,947	7.38	1,992	.09	36,619	116,336	14.30	63,250	6 1/2 free = 8.39 gross	48,086	5.91	113,690	10.83
26	3,115,875	6.03	228,147	.44	1,240,431	1,647,297	10.83	1,174,993	7.72	472,304	3.11	6,686,962	43.96
	2,848,313	5.66	209,796	.42	1,203,309	1,436,209	9.86	1,054,090	7.24	581,119	2.62	6,190,511	42.12
27	267,562	.37	18,352	.02	37,122	212,088	.97	120,903	.48	91,185	.49	556,451	1.84



## THE INVESTMENT TRUST

BRITISH INVESTMENT TRUST COMPANIES—(Continued)

Company	DEBENTURE*				PREFERENCE*				ORDINARY*			
	Per Cent.	Highest and Lowest Prices, 1924	Approximate Present Price	Yield %	Per Cent.	Highest and Lowest Prices, 1924	Approximate Present Price	Yield %	Per Cent.	Highest and Lowest Prices, 1924	Approximate Present Price	Yield %
1	{ 4 4½	80 - 77½ 83 - 78½	77-79 81-83	5.13 5.18	5	93 - 88	92-94	5.38	12	181½-141½	201-205	5.91
2	4	80½-77	76-78	5.20	5	93½-88½	93-96	5.29	12	157½-140	175-180	6.76
3	4	80½-77	79-81	5	4½	88 - 82½	85-88	5.20	8½	131 - 111	148-153	5.65
4	—	—	—	—	5	84 - 71	80-83	6.13	5	61½- 44	66- 69	7.41
5	4	79½-77	77-79	5.13	5	93 - 88	91-93	5.43	7½	121 - 99	116-119	6.38
6	—	—	—	—	5	97 - 90	94-97	5.24	7½	116 - 107	118-122	6.25
7	4	79 - 75½	75-77	5.26	5	88 - 83	83-86	5.92	10	120 - 104½	138-143	7.12
8	4	77 - 75	74-77	5.30	4½	80½-73	84-86	5.29	9	141½-107	165-170	5.37
9	{ 4 4½	79 - 73½ 80 - 77½ 80 - 76½	74-77 78-81 78-81	5.30 5.66 5.03	5	87½-83	86-89	5.71	8	118 - 98	124-127	6.37
10	4	80 - 76½	78-81	5.03	4½	87 - 81	84-87	5.26	10	172 - 120	180-185	5.48
11	{ 4 4½	72½-67 83 - 77½ 77½-74	68-71 78-81 76-79	5.04 5.03 5.16	4½	88½-82½	87-90	5.08	14	232 - 183	260-270	5.28
12	4	77½-74	76-79	5.16	4½	79 - 74	78-81	5.66	7	108 - 85	116-121	5.91
13	4	81½-77½	80-82	4.94	4	78½-74	75-78	5.23	19	327½-260½	352-362	5.32
14	4	74½-74½	76-78	5.20	{ 5 5½	92½-83 90 - 85 86 - 78	94-96 87-90 82-85	5.26 6.21 5.39	8	177 - 128	140-145	5.62
15	4	82 - 78	77-79	5.13	4½	86 - 78	82-85	5.39	10	166½-134	158-163	6.23
16	{ 4 3½	80½-76½ 68½-67½	76-79 66-69	5.16 5.18	5	95½-88½	91-95	5.38	12½	231 - 174½	215-220	5.75
17	{ 4 4½	82 - 77 85 - 79½ 80½-75½	69-81 81-84 77-79	5 5.15 5.13	5	97 - 93	93-96	5.29	12	205½-156½	220-225	5.39
18	4	80½-75½	77-79	5.13	4	77 - 73½	75-78	5.23	11	158 - 133	181-186	5.99
19	4	81½-77	78-81	5.03	4½	85 - 79	86-89	5.14	17½	315 - 254	345-355	5.00
20	4½	85½-79½	84-87	5.26	5	85½-80	86-89	5.71	8	113 - 91	124-127	6.37
21	—	—	—	—	—	—	—	—	7½	135½- 99½	136-141	5.42
22	{ 4 4½	78 - 75½ 84½-78	76-79 81-83	5.16 5.18	5	95 - 88	93-97	5.26	10	165 - 124½	170-175	5.80
23	—	—	—	—	4½	83½-82½	81-84	5.45	10 de- clared for 1925/6	180 - 174	181-185	5.46

\* PRICES: HIGHEST AND LOWEST, 1924  
APPROXIMATE PRICE 28TH MAY, 1925, AND YIELD PER CENT AT THAT DATE



## II

## SCOTTISH INVESTMENT TRUST COMPANIES

(Compiled for "*The Financial Times*" of London, with the following explanatory statement)

This comprehensive table has been compiled from the latest reports available, and sets out clearly and in a concise form the results attained, both individually and collectively, by the companies in question for the past two years. The accounts prove conclusively that the trust company principle is well understood and applied across the Border.

During the past twelve months these representative Scottish companies earned, in the aggregate, £1,978,385, or 6.30 per cent, on the capital employed, against £1,770,545, or 6.21 per cent, in the previous year, an increase of £207,840, or .09 per cent. In considering this improvement it must be borne in mind that certain new share and debenture capital was only gradually received during the year, and consequently a full year's income was not received on this new money.

After meeting all expenses of management, the amount required to pay interest on borrowed money, preference dividends, etc., is covered more than twice over, and the Scottish companies take advantage of this to raise considerable sums of temporary cheap money, from time to time, as required, in the form of terminable debentures, loans or deposits. This temporary money is used expertly to good advantage at higher rates of interest, and helps to swell the balance of income remaining for the ordinary stockholders.

For the past year the balance revenue available for the ordinary stock holders amounts in the aggregate to £1,062,398, or 14.49 per cent net, against £920,591, or 13.84 per cent net, for the preceding period, representing an improvement of £141,807, or .65 per cent. These increased earnings have resulted in a general advance in the rates of dividends paid. This year the total paid away to the ordinary stockholders amounted to £739,619, an average of 10.09 per cent net, against £654,211, or 9.84 per cent net, in the previous year.

The usual conservative policy still maintains in recommending and paying dividends, and the aggregate surplus remaining over for the year is £322,779, or 4.40 per cent net, against £266,380, or 4.00 per cent, last year. This margin of safety not only strongly guards against any risk of reduction of present dividends, but also enables the companies to further consolidate their position by utilizing part of their respective surpluses to good advantage, either in swelling their reserve funds or in writing down the cost of securities.

Reserves and amounts carried forward now total £6,283,995, equal to 85.70 per cent on the ordinary stock issued. In addition, most of the companies are able to report that the valuation of their investments shows an excess over book cost, which constitutes a hidden reserve, although of a fluctuating nature.

	COMPANY	YEAR	CAPITAL ISSUED			
			Debtenture, Terminable Debtentures, Loans, etc.	Preference	Ordinary	Total
			£	£	£	£
1	Alliance Trust Co., Ltd.	1924/25	3,099,324	1,325,752	625,752	5,050,828
		1923/24	2,776,095	1,250,000	550,000	4,576,095
2	American Trust Co., Ltd.	1924/25	406,413	204,708	170,292	781,413
		1923/24	269,830	150,000	100,000	519,830
3	British Canadian Trust, Ltd.	1923/24	266,589	125,000	125,000	516,589
		1922/23	260,378	125,000	125,000	510,378
4	British Investment Trust, Ltd.	1924/25	2,000,000	1,200,000	800,000	4,000,000
		1923/24	2,000,000	1,200,000	800,000	4,000,000
5	Caledonian Trust Co., Ltd.	1924/25	1,033,600	600,000	400,000	2,033,600
		1923/24	597,386	300,000	200,000	1,097,386
6	Clydesdale Investment Co., Ltd.	1923/24	595,404	300,000	200,000	1,095,404
		1922/23	459,525	300,000	200,000	959,525
7	East of Scotland Trust, Ltd.	1923/24	73,089	122,034	81,356	276,479
		1922/23	76,407	122,034	81,356	279,797
8	Edinburgh Investment Trust, Ltd.	1924/25	400,000	360,000	480,000	1,240,000
		1923/24	400,000	360,000	480,000	1,240,000
9	First Scottish American Trust Co., Ltd.	1924/25	280,000	—	300,000	580,000
		1923/24	250,000	—	300,000	550,000
10	Northern American Trust Co., Ltd.	1923/24	1,009,915	750,000	500,000	2,259,915
		1922/23	895,430	600,000	400,000	1,895,430
11	Scottish American Investment Co., Ltd.	1924	1,163,284	1,400,000	1,100,000†	3,663,284
		1923	1,101,406	1,400,000	700,000	3,201,406
12	Scottish Investment Trust Co., Ltd.	1923/24	271,200	250,000	250,000	771,200
		1922/23	291,272	250,000	250,000	791,272
13	Scottish Northern Investment Trust, Ltd.	1924/25	506,950	300,000	200,000	1,006,950
		1923/24	504,636	300,000	200,000	1,004,636
14	Scottish Western Investment Co., Ltd.	1924/25	1,044,650	600,000	400,000	2,044,650
		1923/24	993,830	600,000	400,000	1,993,830
15	Second Edinburgh Investment Trust, Ltd.	1923/24	450,000	300,000	200,000	950,000
		1922/23	450,000	300,000	200,000	950,000
16	Second Scottish American Trust Co., Ltd.	1924/25	392,000	—	400,000	792,000
		1923/24	366,300	—	400,000	766,300
17	Second Scottish Investment Trust Co., Ltd.	1923/24	757,000	450,000	300,000	1,507,000
		1922/23	479,890	286,923	463,077	1,229,890
18	Second Scottish Northern Investment Trust, Ltd.	1924/25	501,730	300,000	200,000	1,001,730
		1923/24	463,278	300,000	200,000	963,278
19	Third Edinburgh Investment Trust, Ltd.	1923/24	270,000	200,000	100,000	570,000
		1922/23	300,000	200,000	100,000	600,000
20	Third Scottish American Trust Co., Ltd.	1923/24	373,500	—	400,000	773,500
		1922/23	380,700	—	400,000	780,700
21	United States Investment Corporation, Ltd.	1924	248,836	150,000	100,000	498,836
		1923	234,686	150,000	100,000	484,686
	Summary	1924/25	£15,143,484	8,937,494	7,332,400	31,413,378
	Summary	1923/24	£13,661,049	8,193,967	6,649,433	28,504,439

† £400,000 "A" Ordinary Shares of £1 each.  
£700,000 10 per cent "B" Ordinary Shares of £1 each.

## TRUST COMPANIES

Company	Gross Revenue, less Income Tax, etc.	% on Capital	Expenses	% on Capital	Debt Interest, Preference Dividends, etc. (less tax)	ORDINARY STOCKS						Reserves and Carry Forward	% on Ordinary Stock
						Balance Revenue Available	%	Amount Paid	%	Surplus for Year	%		
	£		£		£	Net £	Gross	Net £	Gross	£	Gross	£	
1	334,773	6.63	19,299	.38	151,751	163,723	36.74	102,494	23	61,229	13.74	1,477,754	236.16
	299,342	6.54	18,711	.41	143,404	137,227	33.91	89,027	22	48,200	11.91	1,207,774	219.60
2	42,852	5.48	3,556	.46	23,889	15,407	15.45	9,966	10	5,441	15.45	33,943	19.94
	30,583	5.88	3,219	.62	17,185	10,179	13.15	6,190	8	3,989	5.16	37,462	37.46
3	33,197	6.43	1,683	.33	16,968	14,546	14.59	7,979	8	6,567	6.59	37,149	29.75
	28,749	5.63	1,651	.32	17,366	9,732	9.30	7,321	7	2,411	2.30	33,582	26.87
4	280,288	7.00	11,559	.29	111,837	156,892	25.31	117,800	19	39,092	6.31	1,387,942	173.49
	264,106	6.60	11,565	.29	113,460	139,081	22.61	104,550	17	34,531	5.61	1,348,849	168.61
5	79,133	3.89	5,439	.27	44,666	29,028	12.12	26,350	11	2,678	1.12	2,855	.72
	68,322	6.31	4,583	.41	29,187	24,672	16.00	16,412	10	9,260	6.00	75,245	37.71
6	59,765	5.46	4,337	.40	33,245	22,183	14.31	15,500	10	6,683	4.31	55,587	27.79
	45,263	4.72	2,690	.28	26,154	16,419	10.72	13,775	9	2,644	1.72	48,905	24.45
7	13,463	4.87	1,643	.59	7,188	4,632	7.34	3,468	5½	1,164	1.84	7,115	8.75
	11,920	4.26	1,419	.51	7,135	3,368	5.43	3,102	5	264	.43	6,951	8.54
8	86,950	7.01	4,600	.37	24,955	57,395	15.43	44,640	12	12,755	3.43	196,466	40.93
	84,675	6.83	4,621	.37	24,932	55,122	14.82	44,640	12	10,482	2.82	183,902	38.31
9	45,692	7.88	2,720	.47	8,934	34,038	14.62	24,446	10½	9,592	4.12	147,568	49.17
	41,883	7.60	2,705	.49	8,485	30,633	13.18	23,850	10	7,383	3.18	140,976	46.99
10	129,031	5.71	6,686	.30	50,435	71,910	23.20	49,600	16	22,310	7.20	748,749	149.75
	118,444	5.94	6,660	.33	48,894	62,890	20.56	45,875	15	17,015	5.56	611,123	152.78
11	221,042	6.03	14,150	.39	77,383	129,509	—	100,750†	—	28,759	—	646,068	58.73
	208,321	6.51	12,581	.39	76,498	119,242	22.16	96,863	18	22,379	4.16	1,017,510	145.83
12	54,037	7.01	4,493	.58	17,438	32,126	16.58	19,375	10	12,751	6.58	124,722	49.89
	51,905	6.56	3,887	.49	17,203	30,815	16.12	15,922	8	15,523	8.12	111,971	44.79
13	67,456	6.70	4,106	.41	28,589	34,761	21.83	23,875	15	10,886	6.83	158,594	79.30
	63,747	6.35	4,070	.41	29,079	30,598	19.87	20,642	13	9,956	6.27	167,196	78.60
14	126,910	6.21	6,289	.31	54,532	66,089	21.32	43,400	14	22,689	7.32	351,741	87.94
	113,476	5.69	6,362	.32	52,096	55,018	17.85	40,073	13	14,945	4.85	329,887	82.47
15	69,296	7.29	4,855	.51	24,412	40,029	25.83	23,250	15	16,779	10.83	187,735	93.87
	64,098	6.75	4,855	.51	23,959	56,284	23.14	22,875	15	12,409	8.14	171,969	85.98
16	62,215	7.86	3,691	.47	12,854	45,670	14.73	32,551	10½	13,119	4.23	194,778	48.69
	60,417	7.88	3,632	.47	11,625	45,162	14.60	30,917	10	14,245	4.60	186,660	46.67
17	82,649	5.48	7,436	.49	36,953	38,260	16.46	27,900	12	10,360	4.46	154,568	51.52
	51,752	4.21	5,036	.41	24,541	22,175	15.20	14,588	10	7,587	5.20	144,208	—
18	61,956	6.18	4,191	.42	28,081	29,684	18.75	19,000	12	10,684	6.75	76,578	38.29
	53,206	5.62	3,919	.41	25,661	23,626	15.84	14,922	10	8,704	5.84	65,714	32.86
19	41,467	7.28	2,834	.50	15,733	22,900	29.55	9,300	12	13,600	17.55	92,524	92.52
	39,667	6.61	2,834	.47	16,056	20,777	27.16	9,175	12	11,602	15.16	78,923	78.92
20	57,042	7.37	3,637	.47	11,882	41,523	13.39	28,675	9½	12,848	4.14	162,901	40.73
	50,818	6.43	3,677	.47	11,602	35,539	11.75	26,468	8½	9,071	3.00	155,052	38.76
21	29,151	5.84	2,781	.56	14,277	12,093	15.60	9,300	12	2,793	3.60	38,648	38.65
	29,911	6.17	2,745	.57	14,132	13,034	16.91	9,254	12	3,780	4.91	36,087	36.09
	1,978,385	6.30	119,985	.38	796,002	1,062,398	14.49	739,619	10.09	322,779	4.40	6,283,995	85.70
	1,770,645	6.21	111,362	.39	738,592	920,591	13.84	654,211	9.84	266,380	4.00	6,149,736	92.48

† Represents 15 per cent less tax on 400,000 "A" Ordinary Shares, and 10 per cent, less tax on 700,000 "B" Ordinary Shares.

## SCOTTISH INVESTMENT TRUST COMPANIES—(Continued)

Company	DEBENTURE*				PREFERENCE*				ORDINARY*			
	Per Cent.	Highest and Lowest Prices	Approximate Current Price	Yield %	Per Cent.	Highest and Lowest Prices	Approximate Current Price	Yield %	Per Cent.	Highest and Lowest Prices	Approximate Current Price	Yield %
1	—	—	—	—	4½	85½-82	83	5.12	23	461½-429	506½	4.54
	—	—	—	—	4½	80½-77	78½	5.10				
	—	—	—	—	4½	88½-85	83	5.12	22	438½-401½	464	4.74
2	4½	81-79	80½	5.28	5	83½-79½	78	5.13	10	155-115	188	5.32
	4½	82-70	81½	5.25	5	93-89½	93	5.38	8	24/3-14/-	27	5.16
	—	—	—	—	4½ (£5 shs.)	18/6-18/3	18/6pr£1sh.	5.40	8	£7-£6/8/9	£7	5.71
3	—	—	—	—	4½	85/6-80/-	82/6	5.45	8 (£5 sh.)	6½-6½	per £5 sh.	5.71
	—	—	—	—	4½	87/9-84/-	85/6pr£5sh.	5.26	8	—	—	5.71
4	4	82-78½	81	4.94	5	100-92	96½	5.18	19	350-303½	395	4.81
	4	81½-77½	81	4.94	5	—	96	5.21	17	—	345	4.93
	4	79-77	79	5.06	4½	84-78	81½	5.21	11	205-158	231	4.76
5	4	80½-78	79	5.06	4½	82½-78	80	5.31	10	164-135	205	4.88
	5	97	97	5.15	4½	85-80	84	5.36	10	185-140	203	4.93
6	—	—	—	—	4½	—	83½	5.36	10	—	187	5.55
	—	—	—	—	4½	80-78	80	6.25	5½	81-60	91	6.04
7	—	—	—	—	5	78-74	80	6.25	6½	60-47	81	6.79
	4	80½-78½	80½	4.97	4½	89½-84	85½	5.25	12	260-185½	256	4.69
8	—	—	—	—	4½	80-84	87	5.17	12	183-179	260	4.62
9	4	79-78	79	5.06	—	—	—	—	10½	208-171	220 c.d.	4.77
	4	81-79	77½	5.16	—	—	—	—	10	179-171	208	4.80
	3½	70-68	68½	5.11	4	80-77	76½	5.23	16	319-285	336	4.76
10	3½	70-67	70	5	4	82-78	79	5.06	16	—	—	—
	—	—	—	—	—	—	—	—	15% "A"	880-848	319	5.08
11	3½	71-68½	69½	5.03	4	82-76½	77	5.19	85/4½-62/6	85/4½-62/6	80/3	3.74
	—	—	—	—	4	—	78	5.13	Ord.£1sh.	39/-35/6	38/-	5.26
	4½	82-80	81½	5.21	5	97-88½	93	5.38	10% "B"	—	—	—
12	—	—	—	—	4½	82½-78½	81½	5.21	Ord.£1sh.	—	—	—
13	4	80½-76½	80½	4.97	4½	83-77½	80	5.31	15	265-225	305	4.92
	4	82½-78	80	5	4½	83½-79	80½	5.28	13	231½-183½	265½	4.90
14	4	80-77½	81	4.94	4½	—	81	5.25	14	267-235	283	4.95
	4	—	80	5	4½	87-86	88	5.11	13	—	265	4.91
15	4	79½-79	80	5	4½	—	—	—	15	330-295	325	4.62
	—	—	—	—	—	—	—	—	15	240	330	4.65
16	4	80-78	79½	5.03	—	—	—	—	10½	210-177	213½	4.92
	4	82-79	79	5.06	—	—	—	—	10	177-171	210	4.76
17	4	80-78	77½	5.16	4½	87½-83	86½	5.23	12	252½-196	—	—
	4	83½-78	79½	5.03	4½	89-79	87	5.17	12	198-175	234	5.13
18	4	80½-77	81	4.94	4½	83-78½	80	5.31	12	227½-181	250	4.80
	—	—	—	—	4½	85-77½	80	5.31	10	196-150	220	4.65
19	4	92-87	90	4.44	4½	87-86	85½	5.25	12	240-213	235	5.11
20	4	80-78	80	5	—	—	—	—	9½	196-163	198	4.67
	4	81-78	78½	5.10	—	—	—	—	9½	166-158	199	4.65
21	4	80-79	76½	5.23	5	97-95	95	5.26	12	45/-30/-	45/6pr£1sh	5.27

\*APPROXIMATE PRICES AND YIELD PER CENT.

§ Deferred Stock increased to £300,000 and converted into—

200,000 6 per cent "A" Preference Shares of £1 each (approximate current price, 21s. 4½d. per share); and 100,000 Ordinary Shares of £1 each (approximate current price, 4½s. per share).

|| Deferred Stock converted into—

200,000 6 per cent "A" Preference Shares of £1 each (approximate current price, 21s. 4½d. per share); and 100,000 Ordinary Shares of £1 each (approximate current price, 5½s. per share).



The Scottish trust companies, unlike most of the English companies, do not publish a list of investments with their reports, but generally, in lieu thereof they submit tables showing the manner in which the investments are distributed and the various classes of securities held, with the amount of capital invested in each class. This information is illuminating, and enables the stockholders to see for themselves the percentage of capital invested in bonds, debentures, or loans, as also the proportion placed in preference or ordinary stocks.

At one time the Income Tax Acts, so far as trust companies are concerned, were applied differently in Scotland than in England, and the Scottish companies suffered to some extent in having to pay income tax on profits realized on sales of securities, but this particular distinction has been removed, and differences between cost and sale prices of investments are now treated as of a capital nature, and no longer fall into income tax computations.

The debenture stock of the best Scottish trust companies, like the English ones, can be regarded, for all practical purposes, as safe as Trustee securities, and the yield, at present current prices, is round about 5 per cent. The general rate of return on the Preference stocks is slightly over  $5\frac{1}{4}$  per cent, but these stocks are very well secured and are an excellent investment of a permanent fixed dividend-paying nature.

As a result of the careful and sound policy displayed in the management of these companies, a most satisfactory position, both from a revenue and capital standpoint, has been built up, and confidence in their future prosperity is reflected in the high prices now ruling for the ordinary stocks. It is somewhat remarkable that the present return on most of these ordinary stocks is on a slightly lower basis than that obtainable on the debenture and preference stocks, but the progressive nature of the companies and present substantial surpluses, remaining after payment of present dividends, indicate to the intelligent investor the probability of larger distributions in the future as well as possible bonuses arising from the issue of fresh capital, anticipated, to an extent, in present prices.



## APPENDIX H

### COMPOSITION OF THE PORTFOLIO, DECEMBER 31, 1923, BANQUE D'OUTREMER (OVERSEAS BANK) OF BRUSSELS.

Number	Par Value	ISSUER	Inventory Cost	Amount
<b>BANKS AND FINANCIAL SOCIETIES</b>				
1,000 shares	Fr. 500	Banque Arlonaise (lib. de 20 p. c.).....	Fr. 100	Fr. 100,000
2,284 "	500	Banque de Commerce d'Anvers (lib. de 50 p. c.)	250	571,000
571 "	500	" " " (lib. de 20 p. c.)	100	57,100
1,778 "	500	Banque Commerciale du Congo (lib. de 20 p. c.)	100	177,800
2,758 "	500	Banque du Congo Belge (lib. de 50 p. c.)....	250	689,500
4,000 "	500	Banque Belge pour l'Etranger.....	500	2,000,000
2,745 "	500	" " " " (lib. de 25 p. c.)	125	343,125
1,734 "	500	Banque de Flandre.....	500	867,000
4,950 "	500	Banque Française des Pays d'Orient (lib. de 50 p. c.).....	250	1,237,500
6,000 "	500	Banque Générale du Nord (lib. de 50 p. c.)...	250	1,500,000
3,832 "	500	Caisse Générale de Reports et de Dépôts....	500	1,916,000
70 "	250	Crédit Foncier d'Extrême-Orient.....	250	17,500
2,930 "	250	" " " " (lib. de 25 p. c.)	62.50	183,125
5,194 beneficiary certificates	—	Société Coloniale Anversoise.....	500	2,597,000
3,695 beneficiary certificates	—	" " " (lib. de fr. 100)...	100	369,500
<b>RAILWAYS AND NAVIGATION</b>				
1,231 ordinary shares	Fr. 500	Compagnie du Chemin de fer du Congo.....	Fr. 500	Fr. 615,500
9,203 shares	500	Chemins de fer et Minières Prince-Henri....	500	4,601,500
6,181 "	100	Cie Française de Chemins de fer au Dahomey.	100	618,100
889 beneficiary certificates	—	" " " " " " " " " " " "	—	—
1,774 beneficiary shares	—	" " " " " " " " " " " "	—	—
6,100 shares	£ 1	Chinese Central Railways (lib. de 50 p. c.)...	12.50	76,250
80 shares deferred	1	" " " " " " " " " " " "	25	2,000
480 shares	Fr. 1,000	Société Belge de Chemins de fer en Chine....	1,000	480,000
573 "	500	Agence Maritime Internationale.....	500	286,500
592 "	500	" " " " (lib. de 50 p. c.)	250	148,000
4,793 "	500	Compagnie Africaine de Navigation.....	500	2,396,500
3,175 "	500	Compagnie Belge Maritime du Congo.....	500	1,587,500
1,476 registered certificates	100	" " " " " " (lib. de 20 p. c.).....	20	29,520

Number	Par Value	ISSUER	Inventory Cost	Amount
<b>TRAMWAYS</b>				
8,696 tenths of ordinary shares	Fr. 50	Tramways et Eclairage de Salonique.....	50	434,800
20 tenths of dividend paying shares	—	" " " " " .....	—	—
6,000 shares	250	Compagnie Française de Tramways et d'Eclairage Electriques de Shanghai.....	250	1,500,000
9,750 no par value shares	—	Compagnie de Tramways et d'Eclairage de Tientsin.....	200	1,950,000
<b>METALLURGICAL ESTABLISHMENTS</b>				
4,000 shares	500	Ateliers Demoor.....	500	2,000,000
4,845 preferred shares	500	" " .....	500	2,422,500
4,691 shares	200	Ateliers de Construction de Hal.....	200	938,200
890 preferred shares	500	Grandes Chaudronneries de l'Escaut.....	500	445,000
96 common shares	—	" " " " .....	—	—
1,740 shares	500	Chaudronnerie et Robinetterie Belges.....	500	870,000
4,230 no par shares	—	Hauts-Fourneaux et Acières de Differdange-St. Ingbert-Rumelange.....	1,000	4,230,000
1,100 shares	500	La Métallo-Chimique.....	500	550,000
4,000 "	500	Société Générale Métallurgique de Hoboken...	500	2,000,000
4,936 preferred shares	500	Société Métallurgique de Sambre-et-Moselle...	500	2,468,000
2,126 common shares	500	" " " " .....	500	1,063,000
6,001 beneficiary certificates	—	Minerva Motors.....	250	1,500,250
1,595 shares	500	Railways et Signalisation.....	500	797,500
<b>COLLIERIES AND MINES</b>				
8,200 no par shares	—	Charbonnages Réunis "Laura et Vereeniging"	Fr. 500	Fr. 4,100,000
16,107 shares	£ 1	The Chinese Engineering and Mining Co., Ltd.	25	402,675
1,600 preferred shares	500	Soc An. des Mines de Manganèse d'Ouro-Preto	500	800,000
1,650 common shares	—	" " " " " " .....	—	—
2,739 beneficiary shares	—	Charbonnages du Pays de Liège aux Awirs...	500	1,369,500
<b>ELECTRICITY</b>				
5,000 shares	500	Centrales Electriques des Flandres.....	500	2,500,000
1,000 preferred shares	500	Société d'Electricité du Brabant.....	500	500,000
700 common shares	—	" " " " .....	—	—
3,851 preferred shares	500	Société d'Electricité et de Traction.....	500	1,925,500
2,577 shares	500	Société Intercommunale Belge d'Electricité...	500	1,288,500

Number	Par Value	ISSUER	Inventory Cost	Amount
COLONIAL SECURITIES				
564 shares	£ 500	Compagnie Comm. et Agric. d'Alimentation du Bas-Congo (A. B. C.).....	500	282,000
6,111 shares	250	Sté Auxiliaire, Industrielle et Financière de la Comp. des Chemins de fer du Congo Supérieur aux Grands Lacs Africains.....	250	1,527,750
3,333 "	250	Do. (lib. de 20 p. c.).....	50	166,650
5,000 founders certificates	250	Do. ....	250	1,250,000
1,570 shares	500	Société Citas.....	500	785,000
1,364 "	500	Ciments du Congo.....	500	682,000
1,500 "	500	Ciments du Katanga.....	500	750,000
700 preferred shares	Fr. 500	Cie du Congo pour le Commerce et l'Industrie	Fr. 500	Fr. 350,000
1,318 "	—	" " " " " " " " " " " "	100	131,800
1,150 "	500	Cie Cottonnière Congolaise.....	500	575,000
5,000 "	100	Société Belge Industrielle et Minière du Katanga.....	100	500,000
3,500 "	100	Compagnie du Lomami et du Lualaba.....	100	350,000
3,500 "	—	" " " " " " " " " " " "	—	—
1,000 "	500	Société pour la Manutention dans les ports du Congo (lib. de 50 p. c.).....	250	250,000
340 "	Fl.P.B. 250	Maatschappij voor Ondernemingen in Nederlandsch-Indië (lib. de 60 p. c.).....	300	102,000
2,372 "	100	Nederlandsch-Indische Rubber en Koffie Cultuur Maatschappij.....	200	474,400
750 "	100	Do. (lib. de 10 p. c.).....	20	15,000
2,041 "	250	Sumatra Caoutchouc Maatschappij.....	500	1,020,500
130 "	Fr. 500	Compagnie des Produits du Congo.....	500	65,000
2,514 "	500	Société Roça Porto Alegre.....	500	1,257,000
MISCELLANEOUS SECURITIES				
2,840 "	500	Soc. Belge pour l'Exportation Industrielle. . .	500	1,420,000
3,772 "	500	Compagnie Financière Belge des Pétroles. . .	500	1,886,000
5,396 "	500	Fours à coke Semet-Solvay et Piette.....	500	2,698,000
4,385 "	500	Tissage "La Flandre".....	500	2,192,500
896 ordinary shares	500	Soc. anon. Italo-Belge pour l'Ind. des Sucres. .	500	448,000
1,515 dividend paying shares	—	" " " " " " " " " " " "	—	—
9,000 shares	£ 1	Marconi International Marine Communication Co. ....	25	225,000
7,035 "	Fr. 500	The New Antwerp Telephone and Electrical Works.....	500	3,517,500
2,000 "	500	Société de Téléphonie Privée.....	500	1,000,000
4,310 "	250	Compagnie Soutière.....	250	1,077,500
3,875 "	500	Compagnie Belge d'Assurances "L'Urbaine" (20% paid up).....	100	387,500
			TOTAL	Fr. 84,909,045

# APPENDIX J

## PROSPECTUS OF NATION-WIDE SECURITIES COMPANY

### Series A

#### TRUST CERTIFICATES

of the

#### NATION-WIDE SECURITIES COMPANY

Incorporated under the laws of the State of Colorado, 1924.

Trust Certificates, coupons attached, payable to bearer. Denomination:

10, 50, 100, 500 and 1000 Shares each

Secured by stocks of 25 leading Industrial, Public Utility, and Railroad Companies of America, deposited with The Colorado National Bank of Denver, Colorado, Trustee.

American Locomotive Company  
American Telephone and Telegraph Company  
American Tobacco Company  
The Atchison, Topeka and Santa Fe Railway Company  
Canadian Pacific Railway Company  
The Delaware, Lackawanna and Western Railroad Company  
Eastman Kodak Company (of New Jersey)  
Electric Bond and Share Company  
General Electric Company  
The Gillette Safety Razor Company  
The Great Western Sugar Company  
Louisville and Nashville Railroad Company  
The Mountain States Telephone and Telegraph Company  
National Biscuit Company  
The New York Central Railroad Company  
The North American Company  
Pacific Gas and Electric Company  
The Pennsylvania Railroad Company  
The Pullman Company  
Southern Pacific Company  
Standard Oil Company of New Jersey  
The Studebaker Corporation  
Union Pacific Railroad Company  
United States Steel Corporation  
F. W. Woolworth Company

\* \* \* \* \*

Total dividends paid by above companies—About \$4,000,000,000

## THE INVESTMENT TRUST

## TRUST CERTIFICATES

Offer every requisite of a sound investment: security, good return, ready market, diversity, long maturity, stability in price, and permanency of dividends.

On account of the wide diversity of the above enterprises, these Trust Certificates provide an investment, which, based on the income from these 25 corporations, is much safer than if dependent on that of any single one.

## Dividends Quarterly

These Trust Certificates are rated A, By Moody's Investors Service.

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OBJECT

This is an Investment Trust, with Certificates issued in units adaptable to the needs of every investor.

The Certificates are secured by seasoned, marketable, dividend-paying stocks of 25 of the largest and strongest corporations of their kind in America (hereinafter referred to as the Combined Companies). These stocks are deposited, as designated below, with the Colorado National Bank, as Trustee, (hereinafter referred to as the Bank).

## INVESTMENT TRUSTS

Are comparatively new in America, but have been in successful operation in England and Scotland for many years.

The intent of all Trusts is the same,—to provide an investment offering the greatest possible safety, combined with a good return.

The Nation-Wide Securities Co. (hereinafter referred to as the Securities Company) is strictly a holding company, and neither it, nor the Bank, has any connection with the management, financing or operation of any of the Combined Companies.

## SAFETY

The safety of Trust Certificates hinges upon the principle of buying high grade securities, in many lines of business, with wide geographical diversification.

The large investor has always done this, to insure the safety of his principal and income, but the small investor, from lack of capital, has never been able. Trust Certificates now give him such an opportunity.

## ORGANIZATION

Stocks of the Combined Companies, in amounts as specified below, with a total par value of \$12,500, owned by the Securities Company, are deposited



with the Bank, and the Bank delivers and certifies Trust Certificates in blocks of 2500 shares.

The smallest Certificate is for 10 shares, thus giving the holder a  $1/250$  participation in the dividends paid by each block of 300 shares of the Combined Companies.

### DIVERSITY

The Combined Companies deal directly, and in every instance, with necessities; while their revenue comes indirectly from every known business and section in the United States.

These stocks have been selected with the object of securing the maximum of safety, yield and ready market; combined with such stability in price, and certainty of income as can be assured by no company in any single industry.

	† Par Value in Each Block
<b>COMBINED COMPANIES</b>	
X * American Locomotive.....	\$ 500
* American Telephone.....	500
* American Tobacco.....	1,500
Atchison, Topeka and Santa Fe.....	100
Canadian Pacific.....	700
Delaware, Lackawanna and Western.....	100
X * Eastman Kodak (New Jersey).....	100
** Electric Bond and Share.....	100
* General Electric.....	100
XX * Gillette.....	100
* Great Western Sugar.....	1,400
Louisville and Nashville.....	100
Mountain States Telephone.....	500
* National Biscuit.....	100
New York Central.....	500
North American.....	1,100
Pacific Gas and Electric.....	1,400
* Pennsylvania.....	800
* Pullman.....	100
Southern Pacific.....	100
* Standard Oil (New Jersey).....	100
** Studebaker.....	100
Union Pacific.....	2,000
* United States Steel.....	300
* Woolworth.....	100
Total number of shares of above companies.....	300
	† \$12,500

\* Largest of its kind in world.

\*\* Preferred. All other shares are Common.

X Par taken as \$100. † As of Dec. 22, 1924.

XX Par taken as \$50.

### SELECTION

All are sound, seasoned, marketable stocks, with long established dividend records.

They represent great railroad systems, which, combined, reach from the Atlantic to the Pacific, from Canada to the Gulf. The Public Utilities include the leaders in their respective lines. The Industrials represent vital and basic industries.

Each of the 25 stocks has been selected as being among the best in its particular class or location, with the prime object of insuring safety of principal, and permanency of dividends.

Among them, one has had an active market in Denver for 20 years, two are quoted on the New York Curb, the rest on the New York Stock Exchange.

Am. Locomotive, Eastman Kodak and Gillette have no par value; \$10 is par for North American; \$25 for Great Western Sugar, National Biscuit, Standard Oil of N. J., and Woolworth; \$50 for Am. Tobacco, Delaware, Lackawanna & Western, and Pennsylvania; \$100 for the others.

In 5 of the 25 we have specialized for a long time—American Telephone, Great Western Sugar, Gillette, Mountain States Telephone, North American. All rank high, for able management, steady growth, financial strength, liberal return, and promise of long continued dividends.

#### DIVIDENDS

Dividends are payable quarterly; Jan. 1, Apr. 1, July 1, Oct. 1, at The Colorado National Bank, Denver; at Kountze Brothers, New York; or the Bank of California, San Francisco.

Certificates purchased on other than a dividend date do not have the next maturing coupon attached, but instead a dividend check will be sent the purchaser at the rate of 6% per annum from the date payment is received. All other coupons are attached and share in dividends each quarterly period.

Cash dividends, regular or extra, paid by the Combined Companies, and received by the Bank, are paid quarterly by the Bank pro rata to holders of Trust Certificates.

All stock dividends, or rights, paid by the Combined Companies are sold at market by the Bank, and the proceeds, above all expenses, are distributed pro rata to holders of Trust Certificates.

Dividends are paid without deduction for the Bank's services, since the latter is paid by the Securities Co., unless such deduction should be required by some future law of the United States, or of its political subdivisions.

#### EXTRAS AND RIGHTS

Holders of Trust Certificates benefit by all extra dividends and rights. Two stocks, included in this Trust, show how these may add largely to income.

American Telephone recently offered Treasury stock to its stockholders, which rights, when sold, added about \$3.75 per share to the \$9 per share annually paid in regular dividends.

Great Western Sugar has paid \$22,211,000 in regular dividends on its Common stock, and \$24,525,000 in extra dividends.

## NON-ASSESSABLE

Trust Certificates carry no voting power, are full paid and non-assessable.

In case of any change in any of the Combined Companies, incurring expense chargeable to their stockholders, the Bank shall pay the proportionate cost for such shares of stock as it holds, and deduct such amount from future payments.

## ISSUANCE

Trust Certificates amounting to blocks of 2500 shares (no par value) each will be issued whenever units of stock of the Combined Companies are deposited with the Bank.

## SUBSTITUTION

When buying additional stock of the Combined Companies for other units of this Trust, if, on account of price changes or for any reason one or more of the Combined Companies shall be omitted, the sum so set aside for such purpose shall be invested in the remaining stocks. Each unit shall rank alike in value with every other unit.

If, through sale of property or retirement of stock, or for any reason, the shares of one or more of the Combined Companies are sold, the proceeds thus received shall be re-invested in shares of any of the remaining Combined Companies, but in no other, thus continuing the Trust in the same high type of security.

Trust Certificates, in small denominations, may also be exchanged for larger ones, totaling the same par value, or vice versa.

## COUPONS

Each Trust Certificate carries 40 quarterly dividend coupons, dated Jan. 1, 1925, to Oct. 1, 1934, inclusive, on which latter date, unless the Trust has been terminated, the Bank will supply a similar set of 40 quarterly coupons with the same serial number, running from Jan. 1, 1935, to Oct. 1, 1944, inclusive.

## RESTRICTIONS

All units shall be as appears above, unless changed by sale or substitution, in which case approximately the same ratio as in the first unit shall be preserved between Industrial, Public Utility, and Railroad stocks.

All stocks shall be selected from the Combined Companies, and from no others.

## MATURITY

This Trust may run for 20 years, but may be terminated or extended, in either event, by 60 days' notice in writing to the Bank, when signed by owners of 75% in value of all outstanding certificates.

The holder or holders of a total of 2500 shares Trust Certificates may also request the Bank on 10 days' written notice to sell one of the units of stock of the Combined Companies, which the Bank shall do, in numerical order, and pay the proceeds to the holder of said Certificates.

#### INDIVIDUAL PURCHASES

If, instead of buying Trust Certificates, the small investor attempts to apply the same sound principle of diversity by buying one share each in different companies, he may buy a number of high grade securities, but, on account of limited resources, he can purchase only a few.

He is also at a disadvantage as to price, since quotations on the New York Stock Exchange are for 100-share lots, so when buying 1-share lots, he is obliged to pay the minimum commission, which is proportionately much greater than for board lots.

Odd lots invariably cost above the market, and are frequently impossible to buy promptly. When selling, he again encounters the same difficulties; sacrifice of price, large commissions, and slow execution.

Trust Certificates provide a sound investment for any sum, in round numbers, from \$100 up. The 500 and 1000-share Certificates are suitable for larger amounts.

#### YIELD

No two active stocks, even in the same class of business, long give identically the same yield, but from their varied nature and wide difference in earning power, some stocks yield much more than others, without sacrifice of safety or marketability.

Trust Certificates return a higher yield by selecting stocks of the Combined Companies in the combination specified, than by buying equal amounts of each.

In the brief analysis of the Combined Companies, we direct special attention to the description of the six which have the largest sums invested in their stocks, which have been selected for liberal yield, combined with proven earning power, and financial strength.

#### MARKET

Trust Certificates may vary fractionally in price with the aggregate price of stocks of the Combined Companies, and amount of dividends accrued on each, but by avoiding the wide fluctuations to which individual stocks are subject, they provide an unusually stable investment. ¶ < 9

Since they are in bearer form, they require no transfer, thus saving time and expense when buying or selling. They also sell at net prices, requiring no additional commissions.

Certain other types of investment, which offer similar security are heavily taxable, while the freedom of Trust Certificate dividends from taxation under the present Normal Federal Income Tax allows a higher net yield.

It is expected that these Trust Certificates will have a wide distribution throughout the United States, and command a broad and active market.

They offer American investors their first opportunity to participate in the combined dividends of these 25 great corporations.

The two largest in the world are included in the list, but their huge income is dwarfed by the earnings of the Combined Companies.

All sales are for Denver delivery, and for settlement in Denver exchange.

We recommend these Certificates for investment. Price on application.

Dividends are exempt from present Normal Federal Income Tax.

All statements and figures are obtained from official sources or others we consider reliable.  
They are not guaranteed, but we believe them to be accurate.



## APPENDIX K

### CONDITION AND INCOME STATEMENT INVESTMENT TRUST CERTIFICATES, SERIES A, INVESTMENT MANAGERS COMPANY, NEW YORK

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*To Holders of*

#### INVESTMENT TRUST CERTIFICATES, SERIES A

The Indenture under which your Certificates are issued provides for an annual report covering the condition of Investment Trust Fund as of December 31st in each year, but we feel that in this first year you are entitled to a statement covering the period ended June 30th.

The first Certificate was issued January 13, 1925. At the close of business, June 30, 1925, the aggregate face value of Certificates outstanding was \$2,189,900, representing a total of 218,688 shares, issued at an average value of \$1,001.38 per 100 shares.

The actual value of the fund, based on closing quotations (June 30th) for the securities held, in accordance with the terms of the Trust Indenture, was \$2,259,581.19, or \$1,033.24 per 100 shares outstanding.

Statements of Condition at the close of business, June 30, 1925, and of Income for the period, duly certified by the Auditor, will be found on the following pages.

Respectfully submitted.

EDGAR L. SMITH,  
*President.*

## INVESTMENT MANAGERS COMPANY

## INVESTMENT TRUST FUND A

STATEMENT OF CONDITION  
as at Close of Business, June 30, 1925.

## ASSETS

SECURITIES OWNED (Market Value \$1,555,400.00), at cost.....	\$1,512,831.84
INTEREST AND DIVIDENDS RECEIVABLE.....	15,716.94
CALL LOANS.....	700,000.00
CASH.....	14,957.20
	<hr/>
	\$2,243,505.98
	<hr/>

## LIABILITIES

INVESTMENT TRUST CERTIFICATES OUTSTANDING.....	\$2,189,900.00
(Representing 218,688 Shares in Fund)	
DUE INVESTMENT MANAGERS COMPANY.....	2,857.36
(Management Compensation in respect of the quarter year ending June 30, 1925, pay- able July 1, 1925)	
PROVISION FOR DISTRIBUTIONS AT RATE OF 5% PER ANNUM ON FACE VALUE OF CERTIFICATES:	
Payable July 2, 1925.....	\$23,294.29
Payable October 2, 1925 (On Ctfs. issued during June, 1925).....	341.30
	<hr/>
	23,635.59
UNDISTRIBUTED INCOME (per Income Account).....	27,113.03
	<hr/>
	\$2,243,505.98
	<hr/>

THE INVESTMENT TRUST  
INVESTMENT MANAGERS COMPANY  
INVESTMENT TRUST FUND A

STATEMENT OF INCOME  
Period from Jan. 10, 1925, to June 30, 1925

		Rate per cent per annum on Average Face Value of Ctfs. Outstanding
<b>INCOME:</b>	<b>\$69,772.51</b>	<b>9.26%</b>
Consisting of—		
Interest Income.....	\$ 4,916.03	.65
Profit from Sales of Securities...	25,628.56	3.40
Dividends.....	39,227.92	5.21
<b>DEDUCTIONS:</b>	<b>4,988.80</b>	<b>.66%</b>
Management Compensation.....	\$ 4,879.62	.65
Miscellaneous.....	109.18	.01
<b>DISTRIBUTIONS.....</b>	<b>\$64,783.71</b>	<b>8.60%</b>
	37,670.68	5.00%
<b>UNDISTRIBUTED INCOME.....</b>	<b>\$27,113.03</b>	<b>3.60%</b>

AGGREGATE NET VALUE OF SHARES  
Represented by Outstanding Certificates June 30, 1925

	Total	Per 100 Shs.
Face Value of Certificates Outstanding.....	\$2,189,900.00	\$1,001.38
Undistributed Income.....	27,113.03	12.40
Unrealized Profit in Securities Owned:		
Market Value, June 30, 1925..	\$1,555,400.00	
Book Value, cost.....	1,512,831.84	19.46
<b>AGGREGATE NET VALUE OF SHARES.....</b>	<b>\$2,259,581.19*</b>	<b>\$1,033.24*</b>

\* After deducting Management Compensation for the quarter ending June 30, 1925, payable July 1, 1925, and accrued provision for Distributions at the rate of 5% per annum on Face Value of Certificates.

# APPENDIX L

## PROSPECTUS OF MID-EUROPEAN CORPORATION

(From *London Financial Times*)

*A copy of this Prospectus has been filed with the Registrar of Joint Stock Companies*

Application will be made in due course to the Stock Exchange Committee for special permission to deal in and for an Official Quotation of the whole of the Shares of the Corporation.

The Subscription List will be closed on or before the 13th November, 1924.

### THE MID-EUROPEAN CORPORATION LIMITED

(Incorporated under the Companies Acts, 1908 to 1917.)

Capital Authorised - £1,000,000 in Shares of £10 each.

Capital Issued - - - £400,000 in Shares of £10 each.

Issue of

60,000 SHARES OF £10 EACH

AT £10 10S. PER SHARE,

ranking for dividend *pari passu* with the existing Shares of the Corporation.

### HAMBROS BANK LIMITED

are authorised by the Corporation, as its Bankers, to receive Subscriptions for the above 60,000 Shares at £10 10s. per Share,

#### PAYABLE AS FOLLOWS:

On Application - - - - -	£2	10	0	
On Allotment - - - - -	£5	10	0	(including 10s. premium),
At Call, subject to one month's notice - - - - -	£2	10	0	

#### Directors:

HENRY CHARLES HAMBRO, 70, Old Broad-street, London, E.C.2, Director of Hambros Bank Limited (*Chairman*).

HAROLD BENDIXSON, 70, Old Broad-street, London, E.C.2, Director of Hambros Bank Limited.

PERCY CHARLES CRUMP, O.B.E., 142, Holborn-bars, London, E.C.1, Fellow of the Institute of Actuaries.

JULIAN DAY, M.C., 13, Austin Friars, London, E.C.2, Director of British Trade Corporation.

NORMAN EDWARD HOLDEN, of Haes and Sons, 24, Throgmorton-street, London, E.C.2, a member of the London Stock Exchange.

EDWARD DE STEIN, Pinners Hall, Austin Friars, London, E.C.2, Managing Director of Constructive Finance and Investment Company, Limited.  
 LIEUT.-COL. THE HON. FRANCIS VERNON WILLEY, C.M.G., C.B.E., M.V.O., 6, Dean's-yard, London, S.W.1, Governing Director of Francis Willey and Co., Ltd.

Bankers:

HAMBROS BANK LIMITED, 70, Old Broad-street, London, E.C.2.  
 BRITISH TRADE CORPORATION, 13, Austin Friars, London, E.C.2.

Solicitors:

LINKLATERS AND PAINES, 2, Bond-court, Walbrook, London, E.C.4.

Auditors:

GEORGE A. TOUCHE AND CO., Basildon House, 7-11, Moorgate, London, E.C.2.  
*Chartered Accountants.*

Secretary and Registered Offices:

REGINALD JAMES GODFREY, Broad-street House, New Broad-street, London, E.C.2.

*Chartered Secretary.*

PROSPECTUS

The Corporation was formed in June, 1924, for the purpose of investing its funds in Central Europe to take advantage of the high rates of interest and the general want of Capital on the Continent.

Of the authorised capital of £500,000, divided into 50,000 Shares of £10 each, 40,000 Shares were subscribed privately at par. 39,990 of these Shares have been called up to the extent of £7 10s. per Share, and the remaining 10 Shares have been paid up in full. The uncalled balance of £99,975 will be called up so as to be payable with the final instalment payable on the Shares of the present issue.

The bulk of the available capital of the Corporation has already been employed in making advances at advantageous rates to various Continental undertakings of good standing. In connexion with these advances the Corporation has acquired options over certain blocks of Shares which, under improving conditions on the Continent, should be of great value.

To enable the Corporation to deal with business now offered by some of the most important concerns on the Continent, the Directors have decided to increase the capital to £1,000,000.

The Corporation is in cooperation with the following banks and bankers abroad:—L. Behrens and Sohne, in Hamburg, Niederoesterreichische Escompte-Gesellschaft, in Vienna, Comptoir d'Escompte de Geneve, in Geneva, and Pester Ungarische Commercial Bank, in Budapest.

The Shares of the present issue will rank for dividend *pari passu* with the existing Shares, and will therefore carry the same dividend

The whole of the 60,000 Shares now being issued have been underwritten for a commission of 2 per cent., and an overriding commission of  $\frac{1}{2}$  per cent., by Messrs. Haes and Sons, of 24, Throgmorton-street, London, E.C.2, in which firm Mr. Norman Edward Holden is a partner, under a contract between them



and the Corporation dated 6th November, 1924. Messrs. Haes and Sons have entered into various sub-underwriting contracts.

The Articles of Association provide as follows with regard to the qualification and remuneration of the Directors:—

80. The qualification of a Director shall be the holding alone and not jointly with any other person of Shares of Stock of the Company of the nominal amount of £100.

81. A Director may act before obtaining his qualification, but if not already qualified shall obtain his qualification within two months after his appointment, or in default his office shall be vacated. If a Director so appointed at any time after the expiration of two months from the date of his appointment ceases to hold his qualification his office shall be vacated. A person vacating office under this Article shall be incapable of being reappointed a Director until he shall have obtained his qualification.

82. The remuneration of the Directors shall be calculated as follows: As soon as may be after the termination of each financial year of the Company the Auditors of the Company shall certify in writing the amount of the profits earned during that year and available for distribution among the Shareholders of the Company (whether actually divided or not) before charging taxation, and after making provision for payment of the interest on any Debentures or Debenture Stock of the Company for the time being outstanding, and the Sinking Fund payments, if any, payable in respect thereof during that year. Five per cent of the amount so certified by the Auditors shall be divided between the Directors in such proportion as the Board may from time to time determine.

83. All Directors shall be entitled to be paid all reasonable expenses incurred by them in the fulfilment of their duties as Directors, including expenses of attending meetings of the Board and meetings of the Company or any class of Shareholders.

Every Share in the Corporation gives the right on a poll to one vote.

The minimum subscription upon which the Directors may proceed to allotment is seven Shares, but the whole of the present issue having been underwritten, the Directors propose to proceed to allotment immediately after the closing of the list. Copies of the Memorandum and Articles of Association of the Company and of the Underwriting Contract can be seen at the Offices of the Corporation's Solicitors during the time the list remains open between the hours of 10 a.m. and 5 p.m.

The preliminary expenses connected with the formation of the Corporation, including £5,000 stamp duty on capital, amounted to £10,376.

In allotting the Shares the Directors will give special consideration to applications made by existing Shareholders of the Corporation.

Application for the Shares should be made on the accompanying form, and forwarded with a cheque for the amount payable on application to Hambros Bank Limited, 3a, London Wall Buildings, London, E.C.2, 70, Old Broadstreet, London, E.C.2, or at Norway House, 21, Cockspur-street, London, S.W.1.

If no allotment is made the deposit will be returned in full. When a less number of Shares is allotted than is applied for, the surplus paid on application will, so far as is necessary, be credited in reduction of the amount to be paid on allotment, and any balance will be returned.

Interest at the rate of seven per cent. per annum will be charged on all instalments unpaid at the due dates. Default in payment of any instalment by its proper date will render the deposit and any instalments previously paid liable to forfeiture and the allotment to cancellation.

A brokerage of 2s. per share will be payable on applications bearing a broker's, banker's, or agent's stamp.

A copy of the Memorandum of Association of the Corporation is printed on the back of the Prospectus, and forms part thereof.

Prospectuses and Forms of Application can be obtained from the Offices of the Corporation, Broad-street House, London, E.C.2, HAMBROS BANK LTD., 3a, London Wall Buildings, London, E.C.2, 70, Old Broad-street, London, E.C.2, or Norway House, 21, Cockspur-street, London, S.W.1, the BRITISH TRADE CORPORATION, 13, Austin Friars, London, E.C.2, MESSRS. HAES & SONS, 24, Throgmorton-street, London, E.C.2, or from MESSRS. BUCHANAN, GAIRDNER, & TENNANT, 19, St. Vincent-place, Glasgow.

Dated the 10th day of November, 1924.

# INDEX

## A

- ACCOUNTING (See also "Profit and Loss Statement")  
 Accrued interest and dividends, crediting, 150  
 Auditor's reports, current valuation of investments, 139  
 Balance-sheet figures vs. market quotations, 124  
 British financing companies, gains on realization, 134  
 Capital gains and losses, 128  
 Contingent funds, 131  
   profit on turnover credited to, 131  
 Market quotations, balance sheet figures, vs., 124  
 Payment of dividends when capital is impaired,  
   conservative practice, 150  
   generally accepted principles, 148  
   Great Britain, 145, 150  
   United States, 143  
 Problems, 124-157  
   synopsis of, 124  
 Records, accuracy and detail, 156  
 Reports for stock and certificate holders, 154  
 Reserves, 129  
 Valuation of investments,  
   factors of safety, 137  
   methods of, 141
- ACCURED DIVIDENDS, Crediting of by British investment trusts, 150
- ACCURED INTEREST, Crediting, by British investment trusts, 150
- AGRICULTURAL CREDIT INSTITUTIONS, 233-237  
   Federal Farm Loan System, 234
- ALEXANDER FUND, 308
- ALLGEMEINE ELECTRICITÄTS GESELLSCHAFT, 229
- ALLIANCE INVESTMENT CO., LTD.,  
   Diversification of risk, 83  
   Dividends, 184
- ALLIANCE TRUST CO., LTD.,  
   Dividends, 183  
   Prospectus of new issues, 73  
   Reserves, 171
- ALLOTMENT LETTERS, Stamp duties, 72
- ALWYN CORPORATION, 306  
   Distributions to certificate owners, 307  
   Management compensation, 307
- AMERICAN AND CONTINENTAL CORPORATION, 256
- AMERICAN AND FOREIGN POWER CO., 240
- AMERICAN BELGIAN FINANCIAL CORPORATION, 260
- AMERICAN-EUROPEAN UTILITIES CORPORATION, 209
- AMERICAN FINANCING COMPANIES, 230-263  
   (See also "Agricultural Credit Institutions," "Financing Investment Trusts," "Holding Companies")  
   Commercial Investment Trust Corporation, 232  
   Electrical Securities Corporation, 235  
   Foreign interests, 357  
   Growth of, 11  
   Operating as financing investment trusts, 357  
   War, effect on, 249
- AMERICAN FINANCING INVESTING TRUSTS, American and Continental Corporation, 256  
   American Belgian Financial Corporation, 260  
   American-European Utilities Corporation, 259  
   American financing companies, operating as, 357  
   American Foreign Securities Co., 253  
   American International Corporation, 249  
   American State Securities Corporation, 247  
   American Superpower Corporation, 246  
   Electric Investors Incorporated, 244  
   European Shares Incorporated, 258  
   Foreign Bond and Share Corporation, 254  
   Foreign Finance Corporation, 253  
   Foreign Trade Financing Corporation, 252  
   General Public Service Corporation, 247  
   German Credit and Investment Corporation, 259  
   International Power Securities Corporation, 235  
   National Food Products Corporation, 248  
   North American Utilities Security Corporation, 248  
   Overseas Securities Corporation, 254  
   Swedish American Investment Corporation, 258  
   Traction and Power Securities, Ltd., 248  
   United States and Foreign Securities Corporation, 256
- AMERICAN AND FOREIGN POWER CO.,  
   Swiss interests in, 226
- AMERICAN FOREIGN SECURITIES CO., 253
- AMERICAN FOUNDERS TRUST, Fiscal agent for International Securities Trust, 296

- AMERICAN INTERNATIONAL CORPORATION,  
249
- AMERICAN INVESTMENT AND GENERAL  
TRUST CO.,  
Dividends, 183  
Investments, shifting of, 197
- AMERICAN INVESTMENT TRUSTS (See also  
"Collateral Trust Bonds," "Common  
Law Trusts," "Massachusetts Trust,"  
"Preferred Stock," "Short-Term  
Credit")  
Alexander Fund, 308  
Alwyn Corporation, 306  
American Bond and Share Corporation,  
328  
American Founders Trust, expense, 163  
Anti-trust legislation, not affecting, 24  
As associations, 32  
As joint management agencies, 300  
Bankstocks Corporation, 320  
diversification of risk, 82, 86  
Bond Investment Trust, 314  
certificates of beneficial interest, 37  
common stock with par value, 40  
declaration of trust, 13  
diversification of risk, 82  
expense arrangements, 163  
not classed as association, 155  
portfolio, 118  
voting rights of common, 39  
Bondshare Corporation, 315  
Borrowing,  
advantages of, 46  
limitations, 31  
Charters, federal, 26  
Classification, 329  
Close market, 70  
Common stock, 36  
emphasis upon, 335  
with par value, 40  
without par value, 40  
Complexity of corporate finance, as fac-  
tor of, 332  
Declaration of trust,  
illustration, 11  
Massachusetts trust operating purely  
as investment trust, 361-371  
Edge Act, incorporation under, 26-31  
Endowed institutions, investment prob-  
lems of affecting, 336  
Expense, 163  
arrangements, 163  
Financial Investing Co., 326  
common stock privileges, 39  
common stock with par value, 40  
geographical distribution of risk, 86  
First Investment Co. of New Hampshire,  
318  
common stock without par value, 40  
preferred stock, 44  
Formal type, 311  
Geographical distribution of investments,  
85  
Importance, 4  
Income, sources of, 158
- AMERICAN INVESTMENT TRUSTS—(Cont'd)  
Incorporation, 26-32  
under banking laws, 31  
under Edge Act, 26-31  
under State law, 31  
International Securities Trust of America,  
282-298  
balance sheet, 377  
borrowing methods, 54  
capital outstanding, 379  
classed as association, 39  
common stock rights, 39  
common stock without par value, 40  
diversification of risk, 84  
estimated surplus, 379  
expense arrangements, 163  
geographical distribution of invest-  
ments, 85, 93  
income account, 379  
investment restrictions, 95  
portfolio, 118  
preferred stock, 47  
reserves, 166  
set up of, 46  
share units, 41  
text of amended declaration of trust,  
361-371  
Investment liaisons with foreign banking  
groups, 259  
Investment Managers Co., 300-306  
common stock with par value, 40  
diversification of risk, 82  
expense, 164  
investment trust certificates, 39, 422  
portfolio, 119  
reserves, 166  
Joint Stock Securities Co., 323  
diversification of risk, 86  
Legal status, 18-35  
Legislation, American vs. British, 12  
Massachusetts Investors Trust, 315  
common stock, 36  
investment trust certificates, with par  
value, 40  
voting rights of common stock, 39  
Morristown Securities Corporation, 328  
common stock privileges, 39  
common stock without par value, 40  
portfolio, 118  
preferred stock, 42  
Nation-Wide Securities Co., prospectus,  
415  
New England Investment Trust, 313  
New York Stock Trust, 330  
Obligations, future of, 340  
Offerings, types of, 339  
Organization,  
as common law trusts, 18  
as corporations, 18, 25  
dates of, 356  
trust vs. corporate form, 21  
Originality among, 282  
Outlook, 332-347  
centralization of management, 345  
emergence of small investor, 332

- AMERICAN INVESTMENT TRUSTS—(Cont'd)**  
 Outlook—(Continued)  
   emphasis upon common share investments, 335  
   impartiality in choosing investments, 345  
   interests of promoters, 343  
   investment problems of endowed institutions, 336  
   investment trust obligations, 340  
   investment trust preferred stock, 342  
   short-term borrowing, 341  
   summary, 436  
   types of investment trust offerings, 339  
   underwriting, 343  
   world creditor position, 333  
 Paucity of,  
   educational work of pioneers, 62  
   effect of yield on foreign vs. domestic investments on, 59  
   psychological factors, 60  
 Payment of dividends while capital is impaired, 143  
 Portfolio,  
   impartiality in choosing, 345  
   specialization in, 325  
   turnover, 118  
 Preferred stock,  
   future of, 342  
   participation rights, 44  
   redemption of, 45  
   voting rights, 45  
 Promoters, interests of, 343  
 Prospect of future, 346  
 Raising of capital, cost, 79  
 Recapitulation, 310  
 Recent developments of, 59  
 Recent growth of, 10  
 Recently organized, 299-331  
 Reports for stock and certificate holders, 154  
 Reserves, 166  
 Securities of, types of, 339  
 Securities Trading and Holding Corporation, 311  
 Short-term borrowing, future of, 341  
 Small investor, advantage to, 332  
 Specialized holdings, 356  
 Stock conversion trust compared with, 299  
 Taxation, 155  
   federal and state, 386  
 Trust vs. corporate form, comparative advantages, 32-35  
 Trusts specializing in shares of financial institutions, 319  
 Types, 299  
 Underwriting, future of, 343  
 Wisconsin Investment Co., 319  
 World creditor position of United States, as factor of, 333  
**AMERICAN STATE SECURITIES CORPORATION,**  
 247  
**AMERICAN SUPERPOWER CORPORATION,** 246  
**AMERICAN TOBACCO Co.,** Dissolution of, 25  
**AMERICAN TRUST Co.,** Preferred stock, ratio, 42  
**AMERICAN TRUSTEE SHARE CORPORATION,**  
 271  
**ANDERSON (JAMES) GROUP OF BRITISH INVESTMENT TRUSTS,** 353  
**ANGLO-AMERICAN DEBENTURE CORPORATION, LTD.,**  
   Change of form, 193  
   Debentures, limitation of, 51  
   Distribution of risk, 92  
   Effect of Baring crisis on, 193  
   Investments,  
     proportion quoted on exchange, 141  
     shifting of, 197  
   Preferred stock, ratio, 42  
**ARMY AND NAVY INVESTMENT TRUST Co., LTD.**  
   Debentures, limitation of, 51  
   Diversification of risk, 83  
   Dividends, 183  
**ASSOCIATED GAS AND ELECTRIC Co.,** 239  
**ASSOCIATIONS,**  
   American investment trusts as, 32  
   International Securities Trust of America  
     classed as, 39  
   Massachusetts Trusts as, 388  
   Taxation of, 389  
   Trust distinguished from, 386  
**AUDITORS,** Reports, current valuation of investments in, 139
- B**
- BALANCE SHEET,**  
   Industrial and General Trusts, Ltd., 380  
   International Securities Trust of America,  
     377  
   Société Générale d'Entreprises, Paris, 384  
**BANCA COMMERCIALE,** 229  
**BANK FÜR ELECTRICHE UNTERNEHMUNGEN,** 229  
**BANKERS INVESTMENT TRUST,** Diversification of risk, 83  
**BANKERS SHARE COMPANIES** (See "Stock Conversion Companies")  
**BANKERS SHARE TRUSTS** (See "Stock Conversion Companies")  
**BANKING LAWS,** Incorporation of American investment trusts under, 31  
**BANKING SERVICES, Société Financière de Transports et d'Entreprises Industrielles,** 218  
**BANKS** (See also "National Banks")  
   Belgian (See "Belgian Banks")  
   Continental, as investment trusts, 208  
   Joint Stock Land Banks, 235  
   Land, 233  
   Loans, Investment trusts, 56  
**BANKSTOCKS CORPORATION,** 320  
   Distribution of risk, 86  
   Organized to purchase bank stock shares, 82  
**BANQUES D'AFFAIRES,**  
   Banque D'Outremer, 209  
   Promotion through, 61



- BANQUE D'OUTREMER, 209-215**  
 Capital, 212  
 Comparison with other Belgian banks, 215  
 General banking and financial service, 211  
 Interest in commercial enterprises, 211  
 Investment trust character of, 209  
 Issues made under direction of, 212  
 Participations, 213  
 Portfolio,  
   composition of, 412  
   geographical distribution, 210  
   type of enterprise, 210  
 Subsidiary companies, 211
- BANQUE DE BRUXELLES, Portfolio, 217**
- BARING CRISIS, Effect on British investment trusts, 192**
- BELGIAN ASSOCIATION POUR LA DÉFENSE DES DÉTENTEURS DE FONDS PUBLICS, Rights of different classes of capital protected by, 116**
- BELGIAN BANKS,**  
 Banque de Bruxelles, portfolio, 217  
 Banque D'Outremer, portfolio, 209-215  
 Mutuelle Mobilière et Immobilière, 215  
 Société General, de Belgique, portfolio, 215
- BELGIAN FINANCING COS., Typical of continental, 222**
- BELGIAN FINANCING INVESTMENT TRUSTS,**  
 Financial connections, 221  
 Société Financière de Transports et d'Entreprises Industrielles, 218  
 Société Générale Belge d'Entreprises Electriques, 221  
 Société Générale de Chemin de Fer Economiques, 221
- BELGIAN INVESTMENT TRUSTS, 218 (See also "Belgian Banks")**  
 Importance of, 207  
 Typical of continental, 222
- BERLINER HANDELSGESELLSCHAFT, 229**
- "BLUE SKY" LAWS, Trusts vs. corporations under, 34**
- BOND INVESTMENT TRUST, 314**  
 Certificates of beneficial interest, 37  
 Common stock,  
   rights, 39  
   with par value, 40  
 Declaration of trust, illustration, 13  
 Expense arrangements, 163  
 Organized to purchase fixed yield securities, 82  
 Portfolio, discretion of trustees regarding, 118  
 Taxation, 155
- BONDS (See also "Collateral Trust Bonds," "Debentures," "Mortgage Bonds")**  
 American investment trust, future of, 340, 342  
 International Securities Trust of America, 290  
 Investment trust,  
   appeal of, 63
- BONDS—(Continued)**  
 Investment trust—(Continued)  
   diversification of issuer's assets, 65  
   marketability of issuer's assets, 64  
   safety of, 64  
   unlikelihood of default, 65  
   Société Général d'Entreprises, 224
- BONDSHARE CORPORATION, 315**
- BORROWING (See also "Bank Loans," "Bonds," "Collateral Trust Bonds," "Debentures," "Mortgage Bonds," "Overborrowing," "Short-term Loans")**  
 American investment trust,  
   trust vs. corporate form of organization, 22  
   limitations, 31  
 British investment trusts, 31  
 Continental financing investment trusts, 31  
 International Securities Trust of America, methods, 54  
 Investment trusts, advantages of, 46
- BREWERY AND COMMERCIAL INVESTMENT TRUST, Dividends, 184**
- BRITISH COMPANIES ACTS, American legislation contrasted with, 12**
- BRITISH CORPORATION OF FOREIGN BOND-HOLDERS, Rights of different classes of capital protected by, 116**
- BRITISH EMPIRE TRUST CO.,**  
 Investment list, 89  
 Profit and loss account, 134
- BRITISH FINANCING COMPANIES,**  
 Border line cases, 9  
 British Empire Trust Co., profit and loss account, 134  
 British trust companies doing a financing business, 355  
 Change to investment trust form, 193  
 Development of, 189  
 Gains on realization, 134  
 National and Foreign Securities Trust, Ltd., profit and loss account, 134  
 Status, 8  
 Taxation, 152
- BRITISH INSURANCE COMPANIES, Investment trust securities purchased by, 64**
- BRITISH INVESTMENT COMPANIES, Second Scottish Investment Trust, reasons for organization, 121**
- BRITISH INVESTMENT TRUST, LTD.,**  
 Distribution of risk, 87  
 Dividends, 183  
 Investments, 197  
 Portfolio, 197  
 Preferred stock, participation rights, 44  
 Reserves, 171
- BRITISH INVESTMENT TRUSTS (See also "Debentures," "Deferred Ordinary Stock," "Dividends," "English Investment Trusts," "Preferred Ordinary Stock," "Risks of Distribution," "Scottish Investment Trusts," "Short-term Loans," "Underwriting")**

## BRITISH INVESTMENT TRUSTS—(Continued)

- Accrued interest and dividends, crediting, 150
- Alliance Investment Trust, Ltd.,
  - diversification of risk, 83
  - dividends, 184
- Alliance Trust Co., Ltd.,
  - dividends, 183
  - prospectus, 73
  - reserves, 171
- Allotment letters, stamp duties, 72
- American Investment and General Trust Co., 197
  - dividends, 183
- American Trust Co., Ltd., preferred stock, 44
  - ratio, 42
- Anglo-American Debenture Corporation, Ltd.,
  - change of form, 193
  - debentures, 51
  - distribution of risk, 92
  - effect of Baring crisis on, 193
  - investments, 141
  - preferred stock ratio, 42
- Army and Navy Investment Trust Co.,
  - debentures, 51
  - dividends, 183
- Bankers Investment Trust, diversification of risk, 83
- Baring crisis, effect on, 192
- Belgian financing investment trusts contrasted with, 220
- Borderland companies, 9
- Borrowing by, 31
  - advantages of, 46
- Brewery and Commercial Investment Trust, dividends, 184
- British Empire Trust Co., investment list, 89
- British Investment Trust, Ltd.,
  - distribution of risk, 87
  - dividends, 183
  - investments, 197
  - portfolio, 197
  - preferred stock, 44
  - reserves, 171
- British Trusts Association, Ltd., 98
- Caledonian Trust Co., dividends, 184
- Capital,
  - outstanding, 9, 187, 354
  - increases, tax, 73
  - present condition, 202
- Capital accounts, 205
- Chronological survey, 187
- Classification, by main groupings, 351
- Common stock,
  - rights, 39
  - with par value, 40
- Companies acts, 195
- Concealed reserves, 203
- Concentrating interests in certain areas or industries, 9
- Conditions in the eighties, 191
- Consolidated Trust, dividends, 183

## BRITISH INVESTMENT TRUSTS—(Continued)

- Continental institutions differentiated from, 223
- Contingent funds, 131, 203
- Debenture Corporation Ltd., secured debentures, 50
- Debenture Securities Investment Co. Ltd.,
  - debentures, 51
  - distribution of risk, 87
  - dividends, 184
  - geographical distribution of investments, 85
- Debentures,
  - outstanding, 354
  - ratio of, 42, 188
- Development,
  - British war finance, 196
  - greater interest in domestic issues, 200
  - increased investment in Latin America, 199
  - larger ratio of prior lien securities, 201
  - shifting of holdings, 197
  - since 1903, 194
  - since the World War, 197
  - tendencies in, 187-206
- Directors, trustee responsibilities of, 121
- Dividends,
  - average, 185
  - causes of failure to pay, 184
- Domestic corporations engaged in foreign business, holdings, 200
- Early, 190
- Earnings, favorable, 205
- Edinburgh Investment Trust,
  - analysis, 174-181
  - dividends, 183
  - new companies organized by, 120
- English differentiated from Scottish, 195
- Expenses, ratios of administrative, 163
- Experience, long, 204
- First Scottish American Trust Co., Ltd.,
  - distribution of risk, 83
- Fleming (Robert) & Co., 98
  - interests, 351
  - reserve policies, 171
- Foreign, American and General Investments Trust Co., investments, 197
- Foreign and Colonial Investment Trust Co., Ltd.,
  - distribution of risk, 87
  - investments, 197
  - limitation of borrowings, 51
- Foreign exchange, effect on holdings, 197, 199
- Foundation, 193
- Founders shares, 77
- Gas, Water and General Investment Trust, Ltd.,
  - diversification of risk, 83
  - effect of Baring crisis on, 193
  - suspense account, 136
- General and Commercial Investment Trust, Ltd., 145
  - debentures, 51
  - dividends, 184

## BRITISH INVESTMENT TRUSTS—(Continued)

- General Investors and Trustees, dividends, 184
- Government and General Investment Co., dividends, 183
- Group agencies, 98
- Holdings (See "Portfolio")
- Importance to underwriting, 97
- Income,
  - miscellaneous sources, 160
  - sources of, 158
- Independent Investment Trust, Ltd.,
  - credit cycle as factor of, 110
- Indian and General Investment Trust, Ltd., diversification of risk, 83
- Industrial and General Trust,
  - directors' fees, 161
  - diversification of risk, 83, 89, 90, 91, 92
  - dividends, 183
  - investments, 199
  - revenue account and balance sheet, 380
- Interlocking directorates, 120
- Investments,
  - in Latin America, 199
  - in the United States, 198
- Investment Trust Corporation, Ltd.,
  - directors' fees, 161
  - distribution of risk, 89, 90, 92
  - dividends, 183
  - memorandum of association, 11
- Investment yield, 159
- Joint management, 120
- Listing of securities, 70
- London and Colonial Investment Corporation, dividends, 184
- London and New York Investment Corporation,
  - debentures, 51
  - dividends, 184
- London Trust Co., dividends, 184
- Management,
  - disinterested, 204
  - expenses, 160
- Memoranda of association of, illustrated, 11
- Mercantile and Anglo group, 351
- Mercantile Investment and General Trust Co., Ltd.,
  - directors' fees, 161
  - dividends, 167
- Merchants Trust,
  - dividends, 184
  - investments in Latin America, 199
  - preferred stock, 44
- Metropolitan Trust Co.,
  - dividends, 183
  - reorganization, 185
  - reserves, 171
- Municipal Trust Co., organization, 191
- New companies, splitting of capital into, 121
- New Imperial Investment Trust, 193
- New Investment Co., dividends, 184
- Northern American Trust Co.,
  - distribution of risk, 89
  - reserves, 171

## BRITISH INVESTMENT TRUSTS—(Continued)

- Omnium Investment Co., directors' fees, 161
- Organization,
  - chronological table, 358
  - corporate, 202
  - to effect financial rearrangements, 9
- Payment of dividends while capital is
  - impaired, 145
  - impaired, 145
  - conservative practice, 150
- Portfolio,
  - domestic issues in, 200
  - management, 202
  - market and balance sheet valuation, 202
  - shifting of since the World War, 197
- Preferred stock,
  - rates, 43
  - voting rights, 45
- Prospectuses of new issues, 73
- Railway Debenture and General Trust Co., Ltd., distribution of risk, 87
- Railway Share Trust and Agency Co.,
  - directors' fees, 161
- Redeemable Securities Investment Trust,
  - shares, 40
- Reserves, 203
  - two classes of, 133
- River Plate and General Investment Trust Co., dividends, 183
- Scottish American Investment Co., Ltd.,
  - capital rearrangements, 169
- Scottish and Dominions Trust, preferred stock ratio, 42
- Scottish and Foreign Trust, Russian bond investments, 185
- Scottish differentiated from English, 195
- Scottish Investment Trust, new companies organized by, 120
- Scottish National Trust, raising of capital, 78
- Scottish Northern Investment Trust, distribution of risk, 89, 91
- Second Edinburgh Investment Trust,
  - analysis, 181
  - profit and loss account, 136
- Second Guardian Trust,
  - management expenses, 162
  - raising of capital, 77
  - shares, 41
- Second Industrial Trust, Ltd., distribution of risk, 90, 91, 92
- Second Mercantile Trust, raising of capital, 78
- Second Scottish American Trust Co., Ltd., distribution of risk, 83
- Second Scottish Investment Trust Co.,
  - dividends, 184
- Second Scottish National Trust Co., Ltd.,
  - voting rights, 44
- Second Scottish Northern Investment Trust, preferred stock ratio, 42
- Securities of, values and yields, 172

**BRITISH INVESTMENT TRUSTS—(Continued)**

- Shares,
  - outstanding, 354
  - splitting of, 40
- Size,
  - interlocking directorates, 120
  - moderate, 120
- Specializing, 9
  - in certain areas or industries, 354
  - splitting for capital reorganization, 121
- South African and General Investment Trust Co., debentures, 50
- Status, 8
- Stock,
  - ratio of preferred to common, 42
  - units, 40
- Stockholders Investment Trust, Ltd.,
  - raising of capital, 79
- Stockholders Investment Trust, short-term loans, 57
- Taxation, 152
  - capital increases, 73
  - double international, 154
- Third Edinburgh Investment Trust, dividends, 184
- Third Scottish American Trust Co., distribution of risk, 83
- Throgmorton Avenue Group, 352
- Trust Union, dividends, 184
- United States and General Trust Corporation,
  - debentures, 53, 188
  - distribution of risk, 90
  - dividends, 184
- United States and South American Investment Trust Co., preferred stock ratio, 42
- United States Debentures Corporation,
  - distribution of risk, 89, 92
  - dividends, 183
  - investments, 141
  - prospectus, 74
- Verner decision, 193
- War experience, 186
- BRITISH TRUST COMPANIES**, Doing a financing business, 355
- BRITISH TRUSTS ASSOCIATION, LTD.**, Purposes, 98
- BRITISH WAR FINANCE**, Investment trusts and, 196
- BROKERAGE FEES**, British investment trusts, 162
- BUSINESS MANAGEMENT**, International Securities Trust of America, not permitted to engage in, 283
- BUSINESS TRUST** (See "Common Law Trust")
- BUYING** (See "Investment Trust Buying")

**C**

- CALEDONIAN TRUST CO.**, Dividends, 184
- CANADA**, Swiss financing companies with interest in, 226
- CAPITAL** (See also "Bank Loans," "Bonds," "Borrowing," "Capital Gain or Loss," "Capital Increase," "Collateral Trust Bonds," "Common Stock," "Debentures," "Mortgage Bonds," "Preferred Stock," "Raising of Capital," "Short-term Loans")
- Accounts, British investment trusts, 205
- American Belgian Financial Corporation, 262
- American Bond and Share Corporation, 329
- American International Corporation, 249
- American investment trust,
  - trust vs. corporate form of organization, 21
- American States Securities Corporation, 247
- American Superpower Corporation, 247
- Bankstocks Corporation, 320
- Banque D'Outremer, 212
- British investment trusts, outstanding, 354
- Credit Mobilier, 224
- Eastern Bankers Corporation, 322
- Edge Act corporations, 28
- Electric Investors, Inc., 246
- English investment trusts, analysis, 402-406
- European Shares, Inc., 258
- Financial and Industrial Securities Corporation, 324
- Financial Investing Co., 326
- First Investment Co. of New Hampshire, 318
- Foreign Finance Corporation, 254
- German Credit and Investment Corporation, 259
- Group, increase of, 122
- Impaired, payment of dividends, 143, 145, 148
- International Securities Trust of America, 290
  - outstanding, 379
- Investment trust, structure of, 36-58
- Istituto di Credito per le Imprese di Pubblica Utilità, 237
- Joint Stock Bond and Share Co., 325
- Joint Stock Securities Co., 323
- Morristown Securities Corporation, 328
- North American Utility Securities Corporation, 248
- Outstanding British investment trusts, 9, 187
- Overseas Securities Corporation, 254
- Raising of,
  - by hypothecation of securities, 236
- International Securities Co. of America, 296
- Italy, 236
- Rearrangements, Scottish American Investment Co., Ltd., 169
- Rights of different classes of, protected by investment trust, 117
- Scottish investment trusts, analysis of, 407-411



**CAPITAL—(Continued)**

- Société Financière Suisse Américaine, 227
- Swedish American Investment Corporation, 258
- Wisconsin Investment Co., 319
- CAPITAL EXPORT** (See "Export of Capital")
- CAPITAL GAIN AND LOSS** (See also "Portfolio, Profit in")
  - Accounting, 128
  - Deductions for loss, Great Britain, 153
  - Taxation of gain, Great Britain, 152
- CAPITAL INCREASE**, British investment trusts, tax, 73
- CAPITALIST SYSTEM**, Investment trust and, 3
- CERTIFICATES OF BENEFICIAL INTEREST**, American investment trusts, preparing reports for, holders, 154
  - Bond investment trust, 37, 344
- CHARTERS**, Federal, American investment trusts, 26
  - Revocation of North River Sugar Refining Co., 24
- CITIES SERVICE CO.**, 240
- COLLATERAL TRUST BONDS**, American investment trusts, 54
  - Definition, 49
  - International Securities Trust of America, 55, 290
- COLLATERAL TRUST SINKING FUND BONDS**, Electrical Securities Corporation, 235
  - International Power Securities Corporation, 235
- COMMERCIAL INVESTMENT TRUST CORPORATION**, 223
- COMMON LAW TRUSTS**, American investment trusts, organized as, 18
  - Attitude of public, 34
  - Blue sky laws, 34
  - Description of, 19
  - Flexibility of, 33
  - Movement, factors in, 24
  - United States, legislation affecting, 20
- COMMON STOCK**,
  - American investment trusts,
    - future of, 341
    - voting rights, 38
  - Bond Investment Trust,
    - voting rights, 39
    - with par value, 40
  - British investment trusts, 39
    - dividends, 165
    - ratio to preferred, 41
    - rights of holders, 39
  - Desirability of, as investments, 115
  - Diversification of, vs. bonds, 114
  - Dividends, rates, 166
  - Edinburgh Trust Co., 177
  - Financial Investing Co. of New York,
    - rights, 39
    - with par value, 40
  - First Investment Co. of New Hampshire, common stock without par value, 40
  - In portfolio, 115

**COMMON STOCK—(Continued)**

- International Securities Co. of America,
  - 39, 290
  - without par value, 40
- Investment Managers Co.,
  - rights, 39
  - with par value, 40
- Investment trusts, 36-41
  - advantages for well-to-do, 67
  - appeal of, 66
  - check-up through purchase of, 67
  - inheritance tax complications avoided through, 67
  - par value, 40
  - Law of increasing stock values, 115
  - Massachusetts Investors Trust, 36
    - voting rights, 39
  - Morristown Securities Corporation,
    - privileges, 39
    - without par value, 40
  - New England Investment Trust, 313
  - Subscription rights, 168
  - With par value, American investment trusts issuing, 40
  - Without par value, American investment trusts issuing, 40
- COMPANIES ACTS**, British investment trusts, 195
- COMPETITION**, Restraint of, through trust, 24
- CONCEALED RESERVES** (See "Contingent Funds")
- CONSOLIDATED TRUST**, Dividends, 183
- CONSOLS**, Quotations, 192
- CONTINENTAL FINANCING INVESTMENT TRUSTS**, Borrowing by, 31
- CONTINENTAL INSTITUTIONS**, 207-229
  - (See also "Belgian Investment Trusts," "French Institutions," "German Institutions")
  - British investment trust, differentiated from, 223
  - Continental investment trusts as financing companies, 207
- CONTINGENT FUNDS**,
  - Accounting, 131
  - British investment trusts, 131, 203
  - Profits on turnover credited to, 131
- CONTROL**, AMERICAN INVESTMENT TRUST, Trust vs. corporate form of organization, 21
- CO-OPERATIVE LOAN ASSOCIATIONS**, 233
- CORPORATE FINANCE**, Complexity, increasing, 332
- CORPORATIONS** (See also "Edge Act")
  - American investment trusts organized as, 18
    - preference for, 25
  - Blue-sky laws, 34
  - Taxation, 32
- CREDIT CYCLE**,
  - As factor of profit, 110
  - Independent Investment Trust, Ltd., use of, by, 110
- CRÉDIT MOBILIER FRANÇAIS**, 224



D

DAVENPORT GROUP OF BRITISH INVESTMENT TRUSTS, 353  
 DEBENTURE BONDS (See "Debentures")  
 DEBENTURE CORPORATION LIMITED,  
     Debentures, 50  
 DEBENTURE SECURITIES INVESTMENT CO., LTD.,  
     Debentures, limited, 51  
     Distribution of risk, 87  
     Dividends, 184  
     Geographical distribution of investments, 85  
 DEBENTURE STOCK, Definition, 49  
 DEBENTURE STOCK TRUSTEES, 50  
 DEBENTURES,  
     American investment trusts, 56  
         future of, 340  
     Anglo-American Debenture Corporation, limitation of, 51  
     Army and Navy Investment Trust Co., limitation of, 51  
     Borrowing powers, limitation of, 50  
     British investment trusts,  
         maturity, 52  
         outstanding, 354  
         perpetual, 52  
         rates, 53  
         ratio, 42, 188  
         ratio of outstanding, 51  
         redemption, 52  
         short-dates, 52  
         terminable, 52  
         waning importance of, 53  
         yield, 53  
     Debenture Corporation Limited, partially secured, 50  
     Debenture Securities Investment Co., limitation of, 51  
     Definition, 49  
     First Federal Foreign Banking Corporation, 27  
     Foreign American and General Investment Trust, limitation of, 51  
     General and Commercial Investment trust, limitation of, 51  
     Issue of, permitted to Edge Act corporation, 27  
     London and New York Investment Corporation, limitation of, 51  
     South African and General Investment Trust Co., partially secured, 50  
     Terminable, popularity in Scotland, 195  
     United States and General Trust Corporation, 188  
         rates, 53  
 DECLARATION OF TRUST,  
     Illustration, 11  
     Bond Investment Trust, illustration, 13  
     Massachusetts trust, operating purely as investment trust, 361-377  
 DEFERRED ORDINARY STOCK, Preferred ordinary stock vs., 45  
 DEFERRED STOCK, In portfolio, 115

DEUTSCHE BANK, 229

DIRECTORS,

    Accountability of, American investment trust, 21  
 Fees,  
     Industrial and General Trust, 161  
     Investment Trust Corporation, 161  
     Mercantile Investment and General Trust Co., 161  
     Omnium Investment Co., 161  
     Railway Share Trust and Agency Co., 161  
     Second Guardian Trust, 162  
     Remuneration of, 161  
     Trustee responsibilities of, 121  
 DISSOLUTION,  
     American Tobacco Co., 25  
     Standard Oil Co., 25  
 DISTRIBUTION OF INVESTMENT TRUST SECURITIES, 69  
 DISTRIBUTION OF RISK,  
     Alliance Investment Trust, 83  
     American investment trusts, geographical, 85  
     Anglo-American Debenture Corporation, Ltd., 92  
     Bankers Investment Trust, 83  
     Bankers share trusts, 86  
     Bankstocks Corporation, 86  
         limitation of, 82  
     Bond Investment Trust, limitations, 82  
     British Investment Trust, Ltd., 87  
     British investment trusts,  
         breadth of, 83  
         illustration, 89  
     By class of undertaking, 86, 91  
     By type of enterprise, 86, 91  
     By type of security, 87, 92  
     Debentures Securities Investment Co., Ltd., 85, 87  
     Efficiency and, 94  
     Financial Investing Co. of New York, 86  
     First, Second and Third Scottish American Trust Companies, Ltd., 83  
     Foreign and Colonial Investment Trust, Ltd., 86  
     Gas, Water and General Investment Trust, Ltd., 83  
     Geographical, 84, 90  
     Indian and General Investment Trust, Ltd., 83  
     Industrial and General Trust, Ltd., 83,  
         89, 90, 91, 92  
     International Securities Trust of America, 84, 85, 93  
     Investment Managers Co., limitation, 82  
     Investment trust buying, standards of, 82  
     Investment Trust Corporation, 89, 90, 92  
     Joint Stock Securities Co., 86  
     Northern American Trust Co., 89  
     Publicity concerning, 87  
         objections to, 88  
     Railway Debenture and General Trust Co., Ltd., 187

## DISTRIBUTION OF RISK—(Continued)

- Scottish Northern Investment Trust, Ltd., 89, 91
- Second Edinburgh Investment Trust, 182
- Second Industrial Trust, Ltd., 90, 91, 92
- Trustee certificate companies, 87
- United States and General Trust Corporation, Ltd., 90
- United States Debenture Corporation, Ltd., 89, 92

## DIVERSIFICATION (See "Distribution of Risk")

## DIVIDENDS,

- Accrued, crediting by British investment trusts, 150
- Alliance Investment Co., 184
- Alliance Trust Co., 183
- American Foreign Securities Co., 253
- American Investment and General Trust Co., 183
- Army and Navy Investment Trust Co., 183
- Bond Investment Trust, 314
- Brewery and Commercial Investment Trust, 184
- British Investment Trust Co., Inc., 183
- British investment trusts,
  - analysis of, 183
  - average, 185
  - causes of failure to pay, 184
  - common stock, 165
  - final, 167
  - interim, 167
- Caledonian Trust Co., 184
- Common stock,
  - an insufficient criterion, 168
  - final, 167
  - interim, 167
  - rates, 166
- Consolidated Trust, 183
- Debenture Securities Co., 184
- Eastern Bankers Corporation, 323
- Edinburgh Investment Trust, 182, 183
- Edinburgh Trust Co., 176, 177
- English investment trusts, 402-406
- First Investment Co. of New Hampshire, 318
- Foreign, American, and General Investments Trust Co., Ltd., interim vs. final, 168
- General and Commercial Investment Trust, 184
- General Investors and Trustees, 184
- Government and General Investment Co., 183
- Indian and General Investment Trust, 183
- Industrial and General Trust, 183
- Investment Trust Corporation, 183
- London and Colonial Investment Corporation, 184
- London and New York Investment Corporation, 184
- London Trust Co., 184

## DIVIDENDS—(Continued)

- Mercantile Investment and General Trust Co., Ltd., interim vs. final, 167
- Merchants Trust, 184
- Metropolitan Trust Co., 183
- New Investment Co., 184
- Payment while capital is impaired, 143, 145, 148
- River Plate and General Investment Trust Co., 183
- Scottish investment trusts, analysis of, 407-411
- Second Edinburgh Investment Trust, 182
- Second Scottish Investment Trust Co., 184
- Third Edinburgh Investment Trust, 184
- Trust Union, 184
- United States and General Trust Corporation, 184
- United States and South American Investment Trust Co., 184
- United States Debenture Corporation, 183
- DOMESTIC CORPORATIONS, Engaged in foreign business, British investment trust holdings, 200
- DOMESTIC INVESTMENTS, Yield vs. domestic, 59

## E

## EARNINGS, 158-186

- American investment trusts, net, 340
- Analysis of typical companies, 174
- British investment trusts, dividends, 183-186
  - favorable, 205
  - value and yield of securities, 172
- vs. American investment trusts, comparison of, 159
- vs. American trusts, 158
- Dividends, 165-172
- Edinburgh Investment Trust, 174-181
- English investment trusts, analysis, 402-406
- Expense arrangements, 163
- Expenses, management, 160-163
- Income,
  - investment, 158
  - miscellaneous sources, 160
  - sources of, 158
- Investment yield, 159
- Scottish investment trusts, analysis of, 407-411
- Second Edinburgh Investment Trust, 181
- EASTERN BANKERS CORPORATION, 322
- EDGE ACT,
  - Capital, high minimum initial, 28
  - Corporations operating under, 27
  - Federal International Banking Corporation of New Orleans, organized under, 27
  - Federal Reserve Board, regulations on, 392-401
  - Financing companies contemplated in, 29
  - First Federal Banking Corporation of New York, organized under, 27

EDGE ACT—(Continued)

- Foreign activities, limitation to, 30
- Incorporation of American investment trusts under, 26-31
- Limitations and defects, 28-31
- Outstanding features, 26
- Over-borrowing, dangers of, 30
- Use of for short term financing, 27
- EDINBURGH GROUP, British Investment Trusts, 352
- EDINBURGH INVESTMENT TRUST,
  - Analysis of, 174-181
  - Conservative management, 177
  - Dividends, 183
  - policies, 182
  - Early difficulties, 176
  - Investments, depreciation, 179
  - New companies organized by, 120
  - Reserves, 177, 181
  - Statistical chronicle, 174
- ELECTRIC BOND AND SHARE CO., 242
- ELECTRIC INVESTORS INCORPORATED, 244
- ELECTRIC POWER COMPANIES,
  - British, investment trusts specializing, 354
- ELECTRICAL ENTERPRISES,
  - Société Financière de Transports et d'Entreprises Industrielles, 218
- ELECTRICAL SECURITIES CORPORATION, 235
- ELLERMAN (SIR JOHN R.), Group of British Investment Trusts, 353
- ENDOW INSTITUTIONS, Investment problems of, 356
- ENGLISH INVESTMENT TRUSTS (See also "British Investment Trusts")
  - Analysis of capital, earnings, dividends and reserves, 402-406
  - Differentiated from Scottish, 195
- EUROPEAN SHARES, INCORPORATED, 258
- EXCHANGE (See "Foreign Exchange")
- EXECUTIVE, Trust, duties of, 123
- EXPENSE,
  - American Founders Trust, 163
  - American investment trusts, arrangements for, 163
  - Bond Investment Trust, 163
  - British investment trusts, management, 160
  - ratio, 163
  - International Securities Trust of America, 163
  - Investment Managers Co., 164
- EXPORT OF CAPITAL, Investment trusts and, 3

F

- FARM MORTGAGE DEBENTURES (See "Agricultural Credit Institutions")
- FEDERAL CHARTERS, American Investment trusts, 26
- FEDERAL FARM LOAN SYSTEM, Mortgage bonds, 234
- FEDERAL INTERNATIONAL BANKING CORPORATION OF NEW ORLEANS,
  - Organization under Edge Act, 27
- FEDERAL RESERVE BOARD, Edge Act regulations, 392-401
- FINANCIAL AND INDUSTRIAL SECURITIES CORPORATION, 324
- FINANCIAL INSTITUTIONS, Trusts specializing in shares of financial institutions, 319
- FINANCIAL INVESTING CO., 326
  - Bankers share, 275
  - Common stock,
    - privileges, 39
    - with par value, 40
  - Geographical distribution of investments, 86
- FINANCIAL REARRANGEMENTS, Investment trusts organized to effect, 355
- FINANCIAL TRUST (See "British Investment Trust")
- FINANCING (See also "Short-term Financing")
- FINANCING COMPANIES (See also "American Financing Companies," "British Financing Companies")
  - Contemplated in Edge Act, 29
  - Continental investment trusts as, 207
  - Investment trusts distinguished from, 7
- FINANCING INVESTMENT TRUSTS (See also "American Financing Investment Trusts," "Belgian Financing Investment Trusts")
  - American financing companies operating as, 357
  - Defined, 242
  - Interest in, recent, 256
  - Outlook, 346
- FIRST FEDERAL FOREIGN BANKING CORPORATION,
  - Debentures issued by, 27
  - Organization under Edge Act, 27
- FIRST INVESTMENT CO. OF NEW HAMPSHIRE, 318
  - Common stock without par value, 40
  - Preferred stock, participation rights, 44
- FIRST SCOTTISH AMERICAN TRUST CO., LTD.,
  - Diversification of risk, 83
- FLEMING (ROBERT) & CO.,
  - British investment trusts, direct interest in by, 351
  - Purposes, 98
  - Reserves, policies, 171
- FLOTATIONS. Occasional, investment trust securities, 71
- FOREIGN, AMERICAN AND GENERAL INVESTMENT TRUST CO., LTD.,
  - Borrowings, limitation of, 51
  - Dividends, interim vs. final, 168
  - Investments, shifting of, 197
- FOREIGN AND COLONIAL INVESTMENT TRUST CO., LTD.,
  - Distribution of risk, 87
  - Holdings, shifting of, 197
  - Investments, shifting of, 197
- FOREIGN BOND AND SHARE CORPORATION, 254
- FOREIGN BUSINESS, Edge Act corporations, limitation to, 30

FOREIGN EXCHANGE,  
 Effect on,  
   American holdings of British investment trusts, 197  
   Latin American holdings of British investment trusts, 199  
 Fluctuations, effect on continental institutions, 226  
 FOREIGN FINANCE CORPORATION, 253  
 FOREIGN GOVERNMENT BOND AND TRUST CERTIFICATES, Financial Investing Co. of New York, 276  
 FOREIGN INTERESTS, American financing companies having, 357  
 FOREIGN INVESTMENTS, Yield vs. domestic, 59  
 FOREIGN LOANS, Yield, London vs. New York, 109  
 FOREIGN TRADE FINANCING CORPORATION, 252  
 FOUNDERS SHARES, British investment trusts, 77  
 FRENCH INSTITUTIONS,  
   Société Centrale pour l'Industrie Electrique, interests of, 223  
   Société Générale d'Entreprises, Paris, 223

**G**

GAS, WATER AND GENERAL INVESTMENT TRUST, LTD.,  
 Diversification of risk, 83  
 Effect of Baring crisis on, 193  
 Suspense account, 136  
 GENERAL AND COMMERCIAL INVESTMENT TRUST, LTD.,  
 Debentures, limitation of, 51  
 Dividends, 184  
 Verner case, 145  
 GENERAL INVESTORS AND TRUSTEES, LTD.,  
 Dividends, 184  
 GENERAL PUBLIC SERVICE CORPORATION, 247  
 GEOGRAPHICAL DISTRIBUTION OF INVESTMENTS, British investment trusts, 84  
 GERMAN CREDIT AND INVESTMENT CORPORATION, 259  
 GERMAN INVESTMENT TRUSTS, 228  
 GERMAN MORTGAGE BONDS, Proposed institution for sale in the United States, 233  
 GOVERNMENT AND GENERAL INVESTMENT Co., Dividends, 183  
 GREAT BRITAIN (See "British Financing Companies," "British Investment Trusts")  
 GREAT WAR, Effect on American financing companies, 249  
 GROUP AGENCIES, British investment trusts, 98  
   Fleming (Robert) & Co., 98

## H

HECHT vs. MALLEY DECISIONS, Association distinguished from trust in, 386

HOLDING COMPANIES, 237-242  
 American and Foreign Power Co., 240  
 Associated Gas and Electric Co., 239  
 Cities Service Co., 240  
 Control, quasi-monopolistic, through, 24  
 Electric Bond and Share Co., 242  
 International Western Electric Co., 242  
 Middle West Utilities Co., 240  
 National Public Service Corporation, 239  
 Public utility, acquisition of foreign interests by, 240  
 Resemblance of continental investment trusts to, 207  
 Taxation of, 389  
 United Light and Power Co., 238  
 Utilities Power and Light Corporation, 238

## I

INCOME STATEMENT,  
 International Securities Trust of America, 379  
 Investment Managers Co., 422  
 INCORPORATION, American investment trusts (See "American Investment Trusts, Incorporation")  
 INDEPENDENT INVESTMENT TRUST, LTD.,  
 Credit cycle as factor of, 110  
 INDIAN AND GENERAL INVESTMENT TRUST, LTD.,  
 Diversification of risk, 83  
 Dividends, 183  
 INDIVIDUAL ESTATES, Comparison with investment trust estates, 103  
 INDUSTRIAL AND GENERAL TRUST, LTD.,  
 Balance sheet, 380  
 Directors' fees, 161  
 Distribution of risk, 83, 89, 90, 91, 92  
 Dividends, 183  
 Investments, South America, 199  
 Revenue account, 380  
 INHERITANCE TAX, Complications, avoidance through purchase of investment trust common, 67  
 INNER RESERVES, British investment trusts, 131, 203  
 INTERLOCKING DIRECTORATES, British investment trusts, 120  
 INTERNATIONAL POWER SECURITIES CORPORATION, 235  
 INTERNATIONAL SECURITIES TRUST OF AMERICA, 282-298  
 Balance sheet, 377  
 Bonds,  
   collateral trust, 290  
   conditions of borrowing, 291  
 Borrowing by, 54  
 Capital,  
   outstanding, 379  
   profits, 288  
   raising of, 296  
   structure, 290  
 Classed as association, 39  
 Close bid and asked market, 298



INTERNATIONAL SECURITIES TRUST OF

AMERICA—(Continued)

- Collateral trust bonds, 55, 290
- Common shares, 292
  - earnings, 292
  - options on, 297
  - protection in exercise of, 297
  - rights, 39
  - without par value, 40
- Declaration of trust, text of amended, 361-377
- Distribution of risk, 84, 93
  - degree in portfolio, 288
  - standards of, 286
- Expense arrangements, 163
- Fiscal agent, relation to, 296
- Geographical distribution of investments, 85
- Income account, 379
- Investments,
  - basic security, 283, 289
  - restrictions, 95
  - tests of application of principle of basic security, 284
- Mortgage bonds, without collateral, 56
- Nature of undertaking, 283
- Organization, 283
- Portfolio,
  - basic soundness of securities purchased, 283, 289
  - discretion of trustees regarding, 118
  - diversification, 288
  - elimination of deteriorating investments, 290
  - guarding, 288
  - management of, 298
  - provisions altering composition of, 285
  - purchases during depressed periods, 287
  - reasonable cost as compared with yield and book value, 289
  - restrictions, 95
  - tests of application of principle of basic security, 284
- Preferred stock, 42, 292
- Reserves, 166
- Securities issued, nature of, 290-296
- Set up of, 46
- Share units, 41
- Surplus, estimated, 379
- Turnover, 118
  - right of, 285

INTERNATIONAL WESTERN ELECTRIC Co., 242

INVESTMENT LISTS,

- British Empire Trust Co., 89
- Publication of, 87
- objections to, 88

INVESTMENT MANAGERS Co.

- Expense arrangements, 164
- Income statement, 422
- Investment trust certificates, 37, 301, 422
  - rights of holders, 39
  - with par value, 40
- Organized to purchase participating interests in common shares, 305

INVESTMENT MANAGERS Co.—(Continued)

- Portfolio,
  - advantages and disadvantages, 304
  - discretion of trustees regarding, 119
  - management, 303
- Reserves, 166
- Security created by, 302
- Statement of conditions, 42
- Taxation, 155
- INVESTMENT TRUSTS (See also "American Investment Trusts," "Borrowing," "British Investment Trust," "Common Stock," "Continental Institutions," "Earnings," "Portfolio," "Preferred Stock")
  - Administration, qualities required, 80
  - Advantages to investor, 15
  - As guardian of small investor's interest, 16
  - Buying, philosophy of, 113
  - Capital, structure of, 36-58
  - Capitalist system and, 3
  - Characteristically a British institution, 207
  - Characteristics, 3-17
  - Common stock, 36-41
  - Continental banks as, 208
  - Creation of, 3
  - Definition, 5
  - Economic vs. legal concept, 6
  - Export of capital as factor of development, 3
  - Financing companies distinguished from, 7
  - Investment income, 158
  - Investments, position on, 112
  - Legal vs. economic concept, 6
  - Management, principles of, 176
  - Organized for purpose of effecting financial rearrangements, 355
  - Origin of, 222
  - Principles,
    - applied, 230
    - diversification of risk, 230
    - raising funds for reinvestment, 231
  - Prospectuses, simplicity in selling, 62
  - Purpose, 3-17
  - Reserves, 129
  - Securities of,
    - appeal of, 63-67
    - British investment trust, value and yield, 172
    - issued, types of, 36
    - market, importance in, 14
  - Size,
    - and efficiency of, 119
    - increasing group capital, 122
  - Stock conversion trust differentiated from, 279
  - Trust companies distinguished from, 6
  - Trust executive, duties of, 123
- INVESTMENT TRUST BUYING,
  - Criteria of investment, 81
  - Distribution of risk, 82-94
    - standards of, 82
  - Importance of sound, 80



## INVESTMENT TRUST CERTIFICATES,

Investment Managers Co., 37, 301, 302,  
422

Rights of holders, 39

With par value, 40

## INVESTMENT TRUST CORPORATION, LTD.,

Directors' fees, 161

Distribution of risk, 89, 90, 92

Dividends, 183

Memorandum of association, illustration,  
11

## INVESTMENTS (See also "Portfolio," "Securities")

Appreciation of, stock bonus due to, 138

Check-up, assurance of through purchase  
of investment trust common, 67Distribution of (See "Distribution of  
Risks")

Investment trust, types of, 36

Market fluctuations,

causes, 125

profits, 127

tendency toward cancellation, 127

Nursing of, by investment trusts, 116

Prior lien, 201

Sound, importance of buying, 80

Valuation,

factors of safety in, 137

in auditors' reports, 139

market and balance sheet, 201

methods of, 141

Yield, foreign vs. domestic, 59

## INVESTOR,

Advantages of investment trust to, 15

Small,

emergence of the, 332

investment trust as guardian of interest  
of, 16INVESTORS SHARE AND UNIT CORPORATION,  
265INVISIBLE RESERVES, British investment  
trusts, 131, 203ISTITUTO DI CREDITO PER LE IMPRESE DI  
PUBBLICA UTILITÀ, 237ITALIAN FINANCING COMPANIES, Istituto di  
Credito per le Imprese di Pubblica  
Utilità, 237ITALIAN INSTITUTIONS, Banca Commerciale,  
229ITALIAN POWER Co. (See "International  
Power Securities Corporation")

## J

JOINT MANAGEMENT, British investment  
trusts, 120

## JOINT MANAGEMENT AGENCIES,

Investment Managers Co., 300-306

Investment trusts as, 300

## JOINT STOCK LAND BANKS, 235

## JOINT STOCK SECURITIES Co., 323

Distribution of risk, 86

## K

KING (SIR HENRY SEYMOUR), Group of  
British Investment Trusts, 353

## L

## LAND BANKS, 233

## LATIN AMERICA,

British investment trusts, investments in,  
199

Merchants Trust, investment in, 199

## LEGAL FEES, British investment trusts, 162

## LEGAL STATUS (See also "Blue Sky Laws")

American investment trusts, 18-35

Edge Act, 26-31

trust vs. corporate form of American, 21

Common law trusts, 20, 24

## Corporations,

American investment trusts organized  
as, 18, 25-32

Massachusetts trusts, 20

## LEGISLATION,

Common law trusts in the United States,  
20Investment trust, British vs. American,  
12LIMITED LIABILITY, American Investment  
Trust, trust vs. corporate form of or-  
ganization, 23LISTING, British investment trust securities,  
70LOANS (See "Bank Loans," "Short-term  
Loans")LONDON AND COLONIAL INVESTMENT COR-  
PORATION, Dividends, 184LONDON AND NEW YORK INVESTMENT COR-  
PORATION,

Debentures, limitation of, 51

Dividends, 184

## LONDON SCOTTISH AND MIDLAND TRUST, 267

## LONDON TRUST Co., Dividends, 184

LORD ST. DAVID'S GROUP, British Invest-  
ment Trusts, 352

## M

## MCLEAN ACT, Authorizations under, 28

MARKETING PROBLEMS, Investment trust  
securities, 69-71

## MASSACHUSETTS INVESTORS TRUST,

Common stock, 36

voting rights, 39

with par value, 40

## MASSACHUSETTS TRUSTS,

As associations, 388

Bond Investment Trust, 314

certificates of beneficial interest, 37

taxation, 155

voting rights of common, 39

Declaration of trust, when operating  
purely as investment trust 361-377

Features of, 20

International Securities Trust of America,  
282

classed as association, 39

common stock rights, 39

Massachusetts Investors Trust, 315

common stock, 36

voting rights of common, 39

MATURITY, Debentures, British investment trusts, 52  
 MEMORANDUM OF ASSOCIATION, Illustration, 11  
     Investment Trust Corporation, Ltd., 11  
 MERCANTILE AND ANGLO GROUP OF BRITISH INVESTMENT TRUSTS, 351  
 MERCANTILE INVESTMENT AND GENERAL TRUST CO., LTD.,  
     Directors' fees, 161  
     Dividends, interim vs. final, 167  
 MERCHANTS TRUST CO.,  
     Dividends, 184  
     Investments in Latin America, 199  
     Preferred stock, participation rights, 44  
 METROPOLITAN TRUST CO.,  
     Dividends, 183  
     Foundation, 193  
     Reorganization, 185  
     Reserves, 171  
 MID-EUROPEAN CORPORATION, Prospectus, 425  
 MIDDLE WEST UTILITIES CO., 240  
 MINES,  
     British investment trusts specializing in, 355  
 MINES AND METALS,  
     Investment trust, 274  
 MORRISTOWN SECURITIES CORPORATION, 328  
     Common stock,  
         privileges, 39  
         without par value, 40  
     Portfolio, discretion of trustees regarding, 118  
     Preferred stock, 42  
 MORTGAGE BONDS,  
     American investment trusts, 56  
     Federal Farm Loan system, 234  
     International Securities Trust of America, without collateral, 56  
 MUNICIPAL TRUST CO., Organization, purpose of, 191  
 MUTUELLE MOBILIERE ET IMMOBILIERE, Status, 215

**N**

NATIONAL AND FOREIGN SECURITIES TRUST, LTD., Profit and loss account, 134  
 NATIONAL BANKS, Investments permitted to, 28  
 NATIONAL FOOD PRODUCTS CORPORATION, 248  
 NATIONAL PUBLIC SERVICE CORPORATION, 239  
 NATION-WIDE SECURITIES CO., 271  
     Prospectus, 415  
 NEW ENGLAND INVESTMENT TRUST, 313  
 NEW IMPERIAL INVESTMENT TRUST, Reorganization, 193  
 NEW INVESTMENT CO., Dividends, 184  
 NEW SECURITIES, Profits, 107  
 NEW YORK STOCK TRUST, 330  
 NORTH AMERICAN UTILITIES SECURITY CORPORATION, 248

NORTH RIVER SUGAR REFINING CO., Charter, revocation of, 24  
 NORTHERN AMERICAN TRUST CO., Distribution of risk, 89  
     Reserves, 171

**O**

OBLIGATIONS, Investment trust, future of, 340  
 OIL, British investment trusts specializing in, 355  
 OMNIUM INVESTMENT CO., Directors' fees, 161  
 OPERATING TRUSTS, Taxation of, 389  
 OVERBORROWING, Edge Act corporations, danger of, 30  
 OVERSEAS SECURITIES CORPORATION, 254

**P**

PACIFIC GAS AND ELECTRIC CO., Swiss interests in, 226  
 PAR VALUE OF COMMON STOCK, Investment trusts, 40  
 PARTICIPATION RIGHTS, Preferred stock, 43  
 PARTICIPATIONS,  
     Banque D'Outremer, 213, 217  
     Société Financière de Transports et d'Entreprises Industrielles, 218  
 PAULL & WILLIAMSON, Group of British Investment Trusts, 353  
 PORTFOLIO (See also "Distribution of Risk," "Investment Lists," "Investments," "Yield")  
     Alexander fund, 309  
     Alwyn Corporation, 308  
     American International Corporation, 250, 251  
     American investment trusts, impartiality in choosing, 345  
     American States Securities Corporation, 247  
     American Superpower Corporation, 246  
     Bankstocks corporation, 321  
     Banque D'Outremer, 209, 217  
         composition of, 412  
     Banque de Bruxelles, 217  
     Bargaining advantages, 105  
     Belgian investment trusts, Banque D'Outremer, 209-215  
     Bond Investment Trust, 118  
     British investment trusts,  
         domestic issues in, 201  
         management, 202  
         market and balance sheet valuations, 201  
         shifting of, 197  
     "Bull" and "Bear" markets, advantages to, 104  
     Business profits in, 106  
     Buying, importance of sound, 80  
     Common stock in, 115  
     Deferred stock in, 115  
     Distribution of risk, 82-94

## PORTFOLIO—(Continued)

- Electric Investors, Inc., 244
- Financial Investing Co., 328
- First Scottish American Trust Co., Ltd., 83
- French companies, 224
- General Public Service Corporation, 247
- Geographical distribution of investments, 84
- Individual estates vs. investment trust, 103
- International Securities Trust of America (See "International Securities Trust of America")
- Investment Managers Co., 119, 303
- Management of, 80-123
  - qualities required, 80
- Massachusetts Investors Trust, 317
- Morristown Securities Corporation, 118
- Nursing of investments, 116
- Overseas Securities Corporation, 255
- Philosophy of, 113
- Points of view, static and dynamic, 102
- Profit in (See also "Capital Gain and Loss")
  - age factor, 107
  - "business profits" in investment, 106
  - credit cycle, factors, 110
  - distance factor, 108
  - market fluctuations, 127
  - on realization, stock bonus from, 138
  - on turnover, employment of, 131
  - realization of, 107-117
  - reinvestment of, 132
  - risk factor, 112
  - turnover, 105
- Restrictions, 95
- Second Scottish American Trust Co., Ltd., 83
- Securities Trading and Holding Corporation, 312
- Société Financière de Transports et d'Entreprises Industrielles, 218, 219
- Société Financière Franco-Suisse, 226
- Société Général de Belgique, 215, 216
- Société General Belge d'Entreprises Electriques, 221
- Société Generale de Chemin de Fer Economiques, 221
- Soundness in,
  - basic, 93
  - criteria of, 81, 95
- Specialization in, 325
- Substitution of collateral in, 54
- Swedish American Investment Corporation, 258
- Swiss financing investment trusts, 227
- Third Scottish-American Trust Co., Ltd., 83
- Trustees, discretion regarding, 118
- Turnover, 102
  - advantages recognized by American investment trusts, 118
  - First Investment Co. of New Hampshire, 318

## PORTFOLIO—(Continued)

- Turnover—(Continued)
  - International Securities Trust of America, right of, 285
  - study required for profits, 105
  - United States and Foreign Securities Co., 257
  - Value, senior vs. junior securities, 114
  - Wisconsin Investment Co., 319
- PREFERRED ORDINARY STOCK, Deferred ordinary stock vs., 45
- PREFERRED STOCK,
  - American investment trusts,
    - future of, 340, 342
    - redemption, 45
    - voting rights, 45
  - American Trust Co.,
    - participation rights, 44
    - ratio, 42
  - Anglo-American Debenture Corporation,
    - ratio, 42
  - British Investment Trust,
    - participation rights, 44
    - rates, 43
    - ratios to common, 41
    - voting rights, 42
  - First Investment Co. of New Hampshire,
    - participation rights, 44
  - International Securities Co. of America,
    - 290
    - ratio, 42
  - Investment trusts, 41-46
    - appeal of, 66
    - high yield, 66
    - units of preferred and common, 66
  - Issue of, advisability of, 45
  - Merchants Trust Co., participation rights, 44
  - Morristown Securities Corporation, ratio, 42
  - Participation rights, 43
  - Redemption of, 43
  - Scottish and Dominions Trust, ratio, 42
  - Second Scottish Northern Investment Trust, preferred stock ratio, 42
  - United States and South American Investment Trust Co., preferred stock ratio, 42
  - Yield American vs. British, 44
- PROFIT AND LOSS STATEMENT,
  - British Empire Trust Co., 134
  - National and Foreign Securities Trust, Ltd., 135
  - Second Edinburgh Investment Trust, Ltd., 136
  - Société Générale d'Entreprises, Paris, 384
- PROFIT-SHARING, Managerial, American International Corporation, 249
- PROFITS (See "Portfolio, Profits")
- PROMOTERS, American Investment Trusts,
  - interest of, 343
- PROMOTING INVESTMENT TRUSTS (See "Financing Investment Trusts")
- PROMOTION, International Securities Trust of America, not permitted to engage in, 283

PROSPECTUSES,  
 Alliance Trust Co., Ltd., 73  
 British investment trusts, 73  
 Mid-European Corporation, 425  
 Nation-Wide Securities Co., 415  
 United States Debentures Corporation,  
 Ltd., 74  
 PUBLIC, Attitude toward common law  
 trusts, 34  
 PUBLIC UTILITY FINANCING, 235  
 PUBLIC UTILITY MANUFACTURE,  
 Foreign interests of American holding  
 companies, 242  
 PUBLIC UTILITIES,  
 Holding companies,  
 acquisition of foreign interests by, 240  
 in field of, 238  
 PURCHASING, Relation to underwriting, 96

Q

QUOTATIONS, American investment trust  
 securities, 70

R

RAILS, British investment trusts specializ-  
 ing in, 354  
 RAILWAY DEBENTURE & GENERAL TRUST  
 Co., LTD., Distribution of risk, 87  
 RAILWAY SHARE TRUST AND AGENCY Co.,  
 Directors' fees, 161  
 RAILWAY TRANSPORTATION ACT, Effect on  
 diverse industries, 93  
 RAISING OF CAPITAL,  
 American investment trusts, cost, 79  
 British investment trusts,  
 cost for long-established trusts, 71  
 costs for new trusts, 76  
 Cost for long-established trusts, 71  
 Cost for new trusts, 76  
 Investment trusts, 59-79  
 Marketing problems, 69  
 Scottish National Trust, 78  
 Second Guardian Trust, 77  
 Second Mercantile Trust, 78  
 Securities, appeal of investment trust, 63  
 Stockholders Investment Trust, Ltd., 79  
 RATES, British investment trusts, preferred  
 stock, 43  
 REDEEMABLE SECURITIES INVESTMENT  
 TRUST, Shares, converted into common  
 stock, 40  
 REDEMPTION,  
 Debentures, British investment trusts, 52  
 Preferred stock, American investment  
 trusts, 45  
 REFINANCING, Specialized British invest-  
 ment trusts for, 9  
 REPORTS, Common law trust not required  
 to make, 33  
 RESERVES,  
 Alliance Trust, 171  
 American investment trusts, 166  
 British Investment Trust, Ltd., 171

RESERVES—(Continued)

British investment trusts, 203  
 concealed reserves, 203  
 contingent funds, 131, 203  
 Edinburgh Trust Co., 177, 180  
 English investment trusts, analysis, 402-  
 406  
 Fleming (Robert) & Co., policies, 171  
 Inner, 131, 203  
 International Securities Trust, 166  
 Investment Managers Co., 166  
 Invisible, 131, 203  
 Metropolitan Trust Co., 171  
 New England Investment Trust, 314  
 Northern American Trust Co., 171  
 Policies, 129  
 Scottish investment trusts, analysis of,  
 407-411  
 REVENUE ACCOUNT, Industrial and General  
 Trusts, Ltd., 380  
 RISK (See "Distribution of Risk")  
 RIVER PLATE AND GENERAL INVESTMENT  
 TRUST Co., Dividends, 183  
 RUBBER, British investment trusts special-  
 izing in, 354

S

SAVINGS BANKS,  
 Position on investments, 112  
 SCOTTISH AMERICAN INVESTMENT Co., LIM-  
 ITED, Capital rearrangements, 169  
 SCOTTISH AND DOMINIONS TRUST, Preferred  
 stock ratio to common, 42  
 SCOTTISH AND FOREIGN TRUST, Russian  
 bond investments, 185  
 SCOTTISH NORTHERN INVESTMENT TRUST,  
 LTD., Distribution of risk, 89, 91  
 SCOTTISH INVESTMENT TRUST Co., LTD.,  
 New companies organized by, 120  
 SCOTTISH INVESTMENT TRUSTS (See also  
 "British Investment Trusts")  
 Analysis of capital, earnings, dividends,  
 and reserves, 407-411  
 English Investment Trusts differentiated  
 from, 195  
 SCOTTISH NATIONAL TRUST, Raising of capi-  
 tal, 78  
 SECOND EDINBURGH INVESTMENT TRUST,  
 LTD.,  
 Analysis, 181  
 Dividend, policies, 182  
 Investments, distribution of, 182  
 Profit and loss accounts, 136  
 War liquidation not profitable, 182  
 SECOND GUARDIAN TRUST,  
 Management expenses, 162  
 Raising of capital, 77  
 Shares converted into common stock, 41  
 SECOND INDUSTRIAL TRUST, LTD., Distribu-  
 tion of risk, 90, 91, 92  
 SECOND MERCANTILE TRUST, Raising of ca-  
 pital, 78  
 SECOND SCOTTISH AMERICAN TRUST Co.,  
 LTD., Diversification of risk, 83



- SECOND SCOTTISH INVESTMENT TRUST Co.,  
Dividends, 184  
Organization, reasons for, 121
- SECOND SCOTTISH NATIONAL TRUST Co.,  
LTD., Voting rights, 44
- SECOND SCOTTISH NORTHERN INVESTMENT  
TRUST, Preferred stock, ratio to com-  
mon, 42
- SECURITIES (See also "Investments")  
Consols, quotations, 172  
Distribution, among small investors,  
332  
New, profits, 107  
Senior vs. junior, comparative investment  
value, 114  
Trustee, overvaluation of, 113
- SECURITIES MARKET (See also "Stock Mar-  
ket")  
Investment trusts, importance in, 14
- SECURITIES TRADING AND HOLDING COR-  
PORATION, 311
- SET UP OF TRUST Co.,  
International Securities Trust of America,  
46
- SHARES (See also "Founders Shares")  
American investment trusts, future of, 340  
British investment trusts,  
outstanding, 354  
splitting of, 40  
units, 40  
International Securities Trust of America,  
units, 41  
Marketability of, American investment  
trust, 22  
Redeemable Securities Investment Trust,  
conversion of, 40  
Second Guardian Trust, conversion of,  
41  
"Split shares," definition, 41
- SHORT-TERM CREDIT,  
American investment trusts, 341  
Appreciation of investment trust principle  
to, 232  
British investment trusts,  
from the public, 58  
limitation of, 57  
Stockholders Investment Trust, 57  
Use of Edge Act for, 27
- SOCIÉTÉ CENTRALE POUR L'INDUSTRIE  
ELECTRIQUE,  
French affiliations, 223  
Interests of, 223
- SOCIÉTÉ FINANCIÈRE DE TRANSPORTS ET  
D'ENTREPRISES INDUSTRIELLES, 218-  
221  
Banking services, 219  
British investment trusts contrasted with,  
220  
Financial connections, 221  
French affiliations, 223  
Portfolio, 219  
Specialization, 218  
Technical and engineering services for af-  
filiated enterprises, 220
- SOCIÉTÉ FINANCIÈRE FRANCO-SUISSE, 224
- SOCIÉTÉ FINANCIÈRE POUR ENTREPRISES  
ELECTRIQUES AUX ETATS UNIS, 226
- SOCIÉTÉ FINANCIÈRE SUISSE-AMERICAINE,  
226
- SOCIÉTÉ FRANCO-SUISSE POUR L'INDUSTRIE  
ELECTRIQUE, 226
- SOCIÉTÉ GÉNÉRALE BELGE D'ENTREPRISES  
ELECTRIQUES, 221
- SOCIÉTÉ GÉNÉRALE D'ENTREPRISES, PARIS,  
223  
Affiliation with Belgian Société Finan-  
cière, 223  
Balance sheet and profit and loss state-  
ment, 384
- SOCIÉTÉ GÉNÉRAL DE BELGIQUE, Portfolio,  
215
- SOCIÉTÉ GÉNÉRALE DE CHEMIN DE FER  
ECONOMIQUES, 221
- SOUTH AFRICAN AND GENERAL INVESTMENT  
TRUST Co., Debentures, 50
- SOUTH AMERICA,  
Exchange, effect on British investment  
trust holdings, 199  
Industrial and General Trust, invest-  
ments in, 199
- SPECIALIZING INVESTMENT TRUSTS, Great  
Britain, 9
- SPENS (NATHANIEL), of British Investment  
Trusts, 353
- SPLIT SHARES, Definition, 41
- STAMP DUTIES,  
British allotment letters, 72  
British investment trusts, documents, 73
- STANDARD OIL Co.,  
Dissolution of, 25  
Trust agreement, 24
- STATE LAW, American investment trusts,  
incorporation under, 31
- STOCK (See "Common Stock," "Deferred  
Ordinary Stock," "Preferred Stock,"  
"Preferred Ordinary Stock," "Shares")
- STOCK BONUS, Appreciation of securities as  
cause of, 138
- STOCK CONVERSION AND INVESTMENT TRUST  
OF LONDON, 266
- STOCK CONVERSION COMPANIES, 264-281  
American investment trust compared  
with, 299  
American Trustee Share Corporation, 271  
Conversion operations, drawbacks to  
British, 268  
Definition, 264  
Diversification of risk, 86  
Features, 271  
Financial Investing Co., 275  
In the United States, 269  
Investment trust differentiated from, 279  
Investors Share and Unit Corporation, 265  
London Scottish and Midland Trust, 267  
Mines and Metals Investment Trust, 274  
Nation-Wide Securities Co., 271  
Principle,  
application of, 265  
recent development, 274  
Pros and cons, 277



STOCK CONVERSION COMPANIES—(Cont'd)  
 Stock Conversion and Investment Trust  
 of London, 266  
 United American Chain Stores, 271  
 United American Electric Companies,  
 Inc., 269  
 United American Railways, 271  
 United Bankers Oil Co., 271  
 STOCK MARKET, "Bull" and "Bear" mar-  
 kets, investment trust and, 104  
 STOCKHOLDERS, American investment trusts  
 preparing reports for, 154  
 STOCKHOLDERS INVESTMENT TRUST, LTD.,  
 Raising of capital, 79  
 Short-term loans, 57  
 SURPLUS, International Securities Trust of  
 America, estimated, 379  
 SUSPENSE ACCOUNTS, Gas, Water and Gen-  
 eral Investment Trust, Ltd., 136  
 SWEDISH-AMERICAN INVESTMENT CORPO-  
 RATION, 258  
 SWISS INSTITUTIONS, 224-228  
 Schweizerische Gesellschaft für Electriche  
 Industrie, 229  
 Société Financière Franco-Suisse, 224  
 Société Financière pour Entreprises Elec-  
 triques aux États Unis, 226  
 Société Financière Suisse-Américaine, 226  
 Société Franco-Suisse pour l'Industrie  
 Electrique, 226

T

"TAP SALES," Investment trust securities,  
 71  
 TAXATION (See also "Inheritance Tax")  
 American investment trust, federal and  
 state, 386  
 Associations, 389  
 Bond Investment Trust, taxation, 155  
 British financing companies, 152  
 British investment trusts,  
 capital increase, 73  
 international double taxation, 154  
 Holding trusts, 389  
 Investment Managers Co., 155  
 Investment trusts, double international,  
 154  
 Operating trusts, 389  
 Stock and certificate holders of American  
 investment trusts, 154  
 Trusts vs. corporations, 32  
 TEA, British investment trusts specializing  
 in, 354  
 THIRD EDINBURGH INVESTMENT TRUST,  
 Dividends, 184  
 THIRD SCOTTISH-AMERICAN TRUST CO.,  
 LTD., Diversification of risk, 83  
 THROGMORTON AVENUE GROUP, BRITISH  
 INVESTMENT TRUSTS, 352  
 TOUCHE (SIR GEORGE) & W. S. POOLE  
 GROUP OF BRITISH INVESTMENT TRUSTS  
 353  
 TRACTION AND POWER SECURITIES, LTD.,  
 248

TRAMWAY COMPANIES, British investment  
 trusts specializing in, 354  
 TRUST AGREEMENTS, Standard Oil Co.,  
 24  
 TRUST COMPANIES,  
 English or Scottish (See "British invest-  
 ment Trust")  
 Investment trusts distinguished from, 6  
 TRUST COMPANY ACTIVITIES,  
 Performed by British investment trusts,  
 160  
 TRUST EXECUTIVE, Duties of, 123  
 TRUST UNION, Dividends, 184  
 TRUSTEE CERTIFICATE COMPANIES (See  
 "Stock Conversion Companies")  
 TRUSTEE SECURITIES, Overvaluation of, 113  
 TRUSTEES, Discretion regarding portfolios,  
 118  
 TRUSTS (See also "Common Law Trusts,"  
 "Massachusetts Trusts")  
 Associations distinguished from, 386  
 Holding, taxation of, 389  
 Legal conception of, 20  
 Operating, taxation, 389  
 Taxation, 32  
 TURNOVER (See "Portfolio, Turnover")

U

UNDERWRITING,  
 British investment trusts, importance to,  
 97  
 Fees, British investment trusts, 160  
 International Securities Trust of America,  
 not permitted to engage in, 283  
 Methods and limitations, 96  
 Participation by American investment  
 trusts, 343  
 Relation to purchasing, 96  
 UNION FINANCIÈRE DE GENEVE,  
 Société Financière Franco-Suisse, affili-  
 ated with, 226  
 UNITED AMERICAN CHAIN STORES, 271  
 UNITED AMERICAN RAILWAYS, 271  
 UNITED BANKERS OIL CO., 271  
 UNITED LIGHT AND POWER CO., 238  
 UNITED STATES,  
 British investment trusts holdings in,  
 198  
 Common law trusts, legislation affecting,  
 20  
 Investment trusts in (See "American In-  
 vestment Trusts")  
 Swiss financing companies with interests  
 in, 226  
 World creditor position, effect on invest-  
 ment trusts, 333  
 UNITED STATES AND FOREIGN SECURITIES  
 CORPORATION, 256  
 UNITED STATES AND GENERAL TRUST COR-  
 PORATION, LTD.,  
 Debentures, 188  
 rates, 53  
 Distribution of risk, 90  
 Dividends, 184

UNITED STATES AND SOUTH AMERICAN INVESTMENT TRUST Co., 184  
 Preferred stock, ratio to common, 42  
 UNITED STATES DEBENTURE CORPORATION, LTD.,  
 Distribution of risk, 89, 92  
 Dividends, 183  
 Investments, proportion quoted on exchange, 141  
 Prospectus of new issues, 74  
 UNITED STATES ELECTRIC COMPANIES, INC., 269  
 "UNITS"  
 Alexander Fund, 308  
 International Securities Trust of America, 296  
 UTILITIES POWER AND LIGHT CORPORATION, 238  
 VALUATION OF INVESTMENTS (See "Investments")

## V

VERNER CASE, Payment of dividends while capital is impaired, 145  
 VOTING RIGHTS,  
 American investment trusts,  
 common stock, 38  
 preferred stock, 45  
 British investment trusts, 44  
 preferred stock, 45

## W

WISCONSIN INVESTMENT Co., 319

## Y

YIELD,  
 British investment trusts, 159, 172  
 Investments, London vs. New York, 109





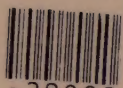




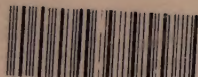
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